Supreme Court, U.S.
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In The

Supreme Court of the United States

CHARLES CONNELL McCARTHY,

Petitioner,

v.

THE SUPREME COURT OF CALIFORNIA;
STATE BAR COURT;
NAZAR H. ASHJIAN, JR.,

Respondents.

On Petition For A Writ Of Certiorari To The Supreme Court Of California

PETITION FOR A WRIT OF CERTIORARI

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27 pp

QUESTIONS PRESENTED

1. Whether, The Supreme Court of California DECISION WITHOUT PUBLISHED OPINION and ORDER **summarily** denying McCarthy's VERIFIED PETITION FOR WRIT OF REVIEW – **without oral argument – without a *judicial* hearing – without a written *judicial* decision – and without a meaningful *judicial* review** of the important federal **ISSUES PRESENTED** therein – deprived Petitioner McCarthy of his due process and equal protection rights under the First and Fourteenth Amendments of the United States Constitution?

2. Whether, California Business and Professions Code Section 6106 (moral turpitude) is unconstitutional on its face for vagueness and overbreadth in violation of the First and Fourteenth Amendments of the United States Constitution?

3. Whether, the California State Bar Review Department may identify the purported factual basis for a "moral turpitude" disciplinary charge for the first time on appeal, after: having not alleged such purported conduct in the Notice of Disciplinary Charges (NDC), having not disclosed such purported conduct at any time in discovery, and having not litigated such purported conduct at the time of trial?

4. Whether, the period of limitations set forth in State Bar Rules of Procedure Rule 51 is unconstitutional?

5. Whether, the Review Department's conclusion that McCarthy had "**wilfully**" violated Business & Professions Code Section 6090.5(a)(2), as alleged in *COUNT TWO* of the NDC – was supported by the facts, the law and the weight of the evidence e.g.:

QUESTIONS PRESENTED – Continued

"The charges against an attorney must be supported by convincing proof and to a reasonable certainty; inferences leading to a conclusion of innocence must be drawn if equally reasonable but conflicting inferences may be drawn from the evidence." (*Sternlieb v. State Bar,* 52 Cal.3d 317, 324 (1990).)" (App. E88)?

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PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully requests that the Court issue a writ of certiorari to review The Supreme Court Of California DECISION WITHOUT PUBLISHED OPINION and ORDER filed December 11, 2002 In the Matter of Charles Connell McCarthy, A Member of the State Bar, Case No. S109242.

OPINION BELOW

The Supreme Court Of California's DECISION WITHOUT PUBLISHED OPINION and ORDER filed December 11, 2002 (App. A) – **summarily** denied Petitioner McCarthy's VERIFIED PETITION FOR WRIT OF REVIEW filed October 15, 2002 (App. E) – after: the Opinion On Review & Order terminating Inactive Enrollment of the Review Department of the State Bar Court filed April 15, 2002 (App. B); the Review Department Order Modifying Opinion filed April 25, 2002 (App. C); and the Decision And Recommendation of the Hearing Department of the State Bar Court filed August 11, 2000 (App. D).

JURISDICTION

The Supreme Court Of California's **summary denial** of Petitioner McCarthy's VERIFIED PETITION FOR WRIT OF REVIEW filed October 15, 2002 (App. E) is "a final judicial decision on the merits" pursuant to California Rules of Court, Rule 954(b). The jurisdiction of this Court is invoked pursuant to 28 U.S.C.A. Section 1257(a)

and Rule 10(c) of the Rules of the Supreme Court of the United States.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press, or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances. U.S. Const. Amend. I.

2. All persons born or naturalized in the United States and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws. U.S. Const. Amend. XIV. Section 1.

3. California Business and Professions Code § 6106 provides in relevant part:

> The commission of any act involving moral turpitude, dishonesty or corruption, whether the act is committed in the course of his [or her] relations as an attorney or otherwise, and whether the act is a felony or misdemeanor or not, constitutes a cause for disbarment or suspension.

4. Rules of Procedure of the State Bar of California Rules 101(b)(1) (2) and (3) requires that:

> (b) The notice of disciplinary charges shall:
>
> (1) Cite the statutes . . . alleged to have been violated, or to warrant the action proposed.
>
> (2) Contain a statement of facts constituting the alleged violations ***in sufficient detail to permit the preparation of a defense.***
>
> (3) Relate the alleged facts to specific statutes . . . alleged to have been violated or to warrant the action proposed.

5. Rules of Procedure of the State Bar of California Rule 51 is unconstitutional on its face and/or as applied in this case.

6. California Business and Professions Code § 6090.5(a)(2) (seeking an agreement to withdraw a state bar complaint).

STATEMENT OF THE CASE

Factual and Legal Genesis

McCarthy's **VERIFIED PETITION FOR WRIT OF REVIEW** was filed on October 15, 2002. (App. E) Petitioner refers to and incorporates herein as though set forth in full, the ***ISSUES PRESENTED*** (App. E75, 76), ***GROUNDS FOR REVIEW*** (App. E76, 77) and ***PETITION*** (App. E77-87) thereof. McCarthy's July 27, 1988 letter to the Kau limited partners, referred to in ¶ 6, p. 5 of McCarthy's Verified Petition, is attached. (App. F)

Petitioner McCarthy's **BRIEF IN SUPPORT OF PETITION FOR WRIT OF REVIEW** (App. E88-105) argues, in relevant part, that:

> **1. These Vague Allegations are Constitutionally Inadequate** (App E89 **B.**) [e.g., of the NOTICE OF DISCIPLINARY CHARGES (NDC) COUNT ONE (Moral Turpitude, Business & Professions Code Section 6106)] citing *Baker v. State Bar,* 49 Cal.3d 804, 816 (1990):
>
> > Once again we are constrained to call to the attention of the State Bar Court the importance of ***identifying with specificity.*** Both the rule or statutory provision that underlies each charge and ***the manner in which the conduct allegedly violated that rule or statutory provision***. . . . This specificity is also ***essential to meaningful review*** of the recommendation of the State Bar Court. (App. E90)
>
> *Rules of Procedure of the State Bar of California* Rule 101(b)(1) (2) and (3) is also cited. (App. E90, 91) (supra pp. 2, 4)

2. Finding Culpability on Facts Identified for the First Time on Appeal Violates McCarthy's Right to Due Process. (App. E93) In finding McCarthy culpable of an act of "moral turpitude" that was not even alleged in the NDC or specified in the OCTC's discovery responses and recommending his suspension, the State Bar has violated McCarthy's right to due process. (App. E94, 95)

3. THE PERIOD OF LIMITATIONS SET FORTH IN STATE BAR RULES OF PROCEDURE RULE 51 IS UNCONSTITUTIONAL. (App. E96) The NDC in this case specifically alleged that the purported violation that is the subject of Count One took place in ***1988***. (NDC 2:20-27; 3:7-9.) Ashjian did not submit a complaint to the State Bar until January 23, 1996 (NDC 4:26-28), nearly eight years later. The OCTC in turn waited nearly four years before filing the NDC on November 24, 1999. In total then, the NDC was ***not filed until over 11 years after the alleged misconduct took place***. In light of the tardy filing of the NDC, McCarthy brought a Motion to Dismiss on the ground that Count One was untimely and should have been dismissed pursuant to State Bar Rules of Procedure, Rule 262. (App. E98)

4. Even the Review Department's switching of the factual predicate cannot defeat the period of limitations defense. By redefining the purportedly wrongful conduct to be of a non-continuing nature, to wit, McCarthy's paying his own distribution, the period of limitations began to run in 1993, when Ashjian could purportedly assert a claim for a constructive trust (*Lezinsky v. Mason Malt Whiskey Distilling Co.*, 185 Cal. 240, 244

(1921)) and had expired by the time the NDC was filed in 1999. (App. E101)

5. "Statutes of limitations and the equitable doctrine of laches constitute a recognition that claims can become stale – documents may be lost and memories fade over time." (*Sequeira v. Rincon-Vitova Insectaries, Inc.*, 32 Cal.App. 4th 632, 637 (1995).) In this case, McCarthy was forced to stand trial in June 2000 on a disciplinary charge that alleged wrongdoing some 12 years prior, in July 1988. (App. E102)

6. Accordingly, this Petition presents an important question of law: whether a party may "ratify" an agreement reached solely through his counsel without ever having "full knowledge of the material facts." In addition, it is respectfully submitted that there is insufficient evidence to support the conclusion that McCarthy "ratified" any such agreement. (App. E104)

There follow two excerpts from Petitioner McCarthy's **REPLY TO BRIEF IN OPPOSITION TO VERIFIED PETITION FOR WRIT OF REVIEW** filed November 14, 2002 (App. G) – with commentary:

1) INTRODUCTION

Nothing in the State Bar's Opposition[1] should persuade this Court not to grant the

[1] California Rules of Court, Rule 952(a) permits the filing of an "Answer;" however, the State Bar's general counsel has filed a document entitled "Brief for Respondent State Bar of California in Opposition to Petition for Review." Although the Petition for Writ of Review is verified under penalty of perjury, the State Bar's "Opposition" is not, in violation of Code of Civil Procedure Section 446(a), which provides that

(Continued on following page)

instant Verified Petition for Writ of Review. Indeed, the Opposition all but admits that Petitioner did not receive a fair trial or appeal and that his case should be reviewed by this Court. (App. G125)

2) STATEMENT OF FACTS

Petitioner respectfully requests that this Court disregard the State Bar's recitation of Facts in its entirety for failure to cite to any portion of the record. The State Bar has instead cited only to the conclusions set forth in the Review Department Opinion, which itself also does not reference any portion of the record. (App. G125)

COMMENTARY:

The State Bar's **"failure to cite any portion of the record"** in its recitation of Facts – instead citing **"only to the conclusions set forth in the Review Department Opinion"** – was preordained, for the Hearing Department's 12 page DECISION AND RECOMMENDATION (App. D) is also totally devoid of any citation of the record! Additionally, the Hearing Department failed to cite any legal authority supporting the bizarre predicate of its *Conclusions: re Count One:*

> When the distribution was made to all limited partners, Mr. Ashjian's share became his property, rather than the partnership's property. As a fiduciary (and a California attorney), respondent was obligated to keep Mr. Ashjian's

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where an initial pleading is verified, "the answer ***shall*** be verified." (Emphasis added)

> distribution share in trust until the dispute over the distribution was resolved. (App. D65)

Thus, The Supreme Court Of California's **summary** DECISION WITHOUT PUBLISHED OPINION and ORDER filed December 11, 2002 (App. A) – left standing **"the conclusions set forth in the Review Department Opinion, which itself does not reference any portion of the record."** (STATEMENT OF FACTS supra p. 6)

The Hearing Department, the Review Department and The Supreme Court Of California disregarded The Supreme Court Of California's mandate in *Brotsky v. State Bar,* 57 Cal.2d 287, 301 (1962) that **"[I]n matters of discipline and disbarment, the state Bar [Court] is but an arm of this court [acting] much as a referee would act as a fact finder for this court."** (cited with approval by The Supreme Court Of California . . . *In re Rose*, 22 Cal.4th 430, 439 (2000); see fn. 2, p. 3 McCarthy's Reply) (App. G126)

McCarthy's Reply (App. G) argues, in relevant part, that:

> **1.** In conduct that is hardly becoming "an arm of this Court"[2] the State Bar's general counsel makes the shamelessly inaccurate argument that "Petitioner claims that the Notice of Disciplinary Charges ("NDC") did not adequately advise him of the factual basis for the charges against him because it alleged 'dishonest' conduct instead of 'breach of fiduciary duty.'" (Opposition, p. 4.)

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[2] "[I]n matters of discipline and disbarment, the State Bar [Court] is but an arm of this court . . . ." (*In re Rose,* 22 Cal.4th 430, 439 (2000).)

"Although the State Bar accurately recites that NDC only alleged 'dishonest' conduct instead of 'breach of fiduciary duty,'" that is ***not*** the basis of the argument raised in the Verified Petition. Rather, the gravamen of Petitioner's argument is this: the factual predicate that purportedly supports the moral turpitude charge – Petitioner's receiving his own share of the Kau partnership distribution (*see* Verified Petition, p. 20; Rev. Dept Opin., p. 15) – was not alleged in the NDC, was not disclosed in the discovery responses provided by the State Bar's Office of Chief Trial Counsel ("OCTC") (*see* Verified Petition, p. 18, n.7), was not litigated at any time during trial, and was raised for the first time on appeal by the Review Department. (App. G126, 127)

2. Thus, the State Bar has proven Petitioner's point: the moral turpitude charge is unconstitutionally based on unalleged, undisclosed, and unproven "facts" that were not raised by the State Bar until the Review Department Opinion. (App. G128)

3. On appeal, in the face of Petitioner's compelling arguments that there had been no misappropriation, the Review Department for the first time changed the factual predicate underlying the moral turpitude charge from "misappropriation of Ashjian's funds" to the unalleged act of simply receiving Petitioner's own distribution. This judicial sleight of hand, while purporting to preserve the Hearing Department's finding of culpability, rendered the State Bar's application of the Rule of Limitations unconstitutional as applied to Petitioner. (App. G129)

4. As to Count Two, the State Bar's Opposition does not dispute that a principal cannot ratify

the transaction of an agent unless the principal has voluntarily accepted the benefit of such transaction and had "full knowledge of the material facts" regarding such transaction. (2 Witkin, Summary of Cal. Law (9th Ed. 1987 and 1999 Supp.) *Agency and Employment* § 89, p 89.) (App. G131, 132)

5. With respect to *Canatella*, Petitioner is simply pointing out that there is a pending federal case in which a federal court could potentially rule that Section 6106 is constitutionally invalid on its face based on the First and Fourteenth Amendments to the United States Constitution. In that event, Petitioner has noted that many of the issues raised in this Verified Petition relating to the moral turpitude charge could well be rendered moot. Accordingly, a stay of this action pending the final outcome in *Canatella* may well be prudent at this time. (App. G134)

Relative to McCarthy's appeal to the Ninth Circuit, referred to at ¶ 15 of McCarthy's Verified Petition For Writ Of Review (App. E82) – a copy of **APPELLANT'S OPENING BRIEF**, filed December 20, 2002, is attached hereto (App. H) – which argues, in relevant part, that:

1. The Bankruptcy Court Committed Reversible Error When It Entered an Order Awarding Partial Summary Judgment in Favor of Ashjian and Against McCarthy

A. <u>Requirements for Application of Collateral Estoppel</u>.

"Collateral estoppel bars relitigation of issues actually adjudicated and ***essential to the judgment*** in earlier litigation between the same parties." (*Garrett v. City and County of San*

Francisco, 818 F.2d 1515, 1520 (9th Cir. 1987) (emphasis added).) However "redetermination of issues is warranted if there is reason to doubt the quality, extensiveness, or fairness of procedures followed in prior litigation." (*Kremer v. Chemical Constr. Co.*, 456 U.S. 461, 481 (1982).) "Accordingly, the collateral estoppel effect of the state court determination . . . here is governed by California law." (*Bugna*, 33 F.3d at 1057.) The United States Constitution requires that California

> must, however, satisfy the applicable requirements of the Due Process Clause. A State may not grant preclusive effect in its own courts to a constitutionally infirm judgment and other state and federal courts are not required to accord full faith and credit to such a judgment. (*Kremer*, 456 U.S. at 482.) (App. H149, 150)

B. Under California law regarding collateral estoppel, if the prior proceeding is a judicial arbitration that does not state the same cause of action as the subsequent proceeding, the doctrine of collateral estoppel does not apply, even if the arbitration award eventually becomes a "final" court judgment: [citing *Flynn v. Gorton*, 255 Cal.Rptr. 768, 771-72 (Cal.Ct.App. 1989)] (App. H150, 151)

C. The California Supreme Court has set forth the following "requirements for invoking collateral estoppel":

(1) the issue ***necessarily*** decided in the previous proceeding is identical to the one that is sought to be relitigated; (2) the previous proceeding terminated with a final judgment on the merits; and

> (3) the party against whom collateral estoppel is asserted was a party to or in privity with a party in the previous proceeding. (*Coscia v. McKenna & Cuneo*, 108 Cal.Rptr.2d 471, 25 Cal.4th 1194, 1201, n.1 (Cal. 2001).) (App. H154)

In addition to the absence of any allegation of "breach of fiduciary duty" or similar misdeed, Ashjian's Arbitration Brief (App. I) explicitly conceded that although he "believed then, and believes now, that defendant McCarthy has engaged in self-dealing, mismanagement, and other breaches of fiduciary duty" that "for purposes of the litigation, ***that is irrelevant***." (ER 00009 (Arbitration Brief, 2:24-28).) (App. H157)

D. Even assuming the doctrine of collateral estoppel established the breach of a fiduciary duty by McCarthy – which it did not (*see* Sections 1A-C *supra*) – it was still improper for the bankruptcy court to have granted partial summary judgment in favor of Ashjian in the light of the absence of any evidence that such purported breach of fiduciary duty *caused* Ashjian any damages. (App. H158)

APPELLEE'S BRIEF, filed February 5, 2003, (App. J) argues, in relevant part, that:

> **1.** McCarthy's attack upon the sufficiency of the Municipal Court judgment and the application of the doctrine of collateral estoppel have been rendered frivolous, if not moot, by the December 11, 2002 decision of the California Supreme Court denying a petition for writ of review and suspending McCarthy from the practice of law for two years for the ***very acts of defalcation in a fiduciary capacity*** that are the

subject of this appeal.[1] (App. J165) McCarthy was ordered to make restitution to Appellee Nazar Ashjian ("Ashjian") for the same sum included in the Municipal Court judgment. The California Supreme Court's denial of a petition for writ of review left standing the detailed decision of the Review Department of The State Bar Court[2] (App. J166) which left no doubt that McCarthy's acts amounted to a defalcation in a fiduciary capacity therefore satisfying the requirements of 11 U.S.C. §523(a)(4).

2. The Supreme Court's decision forms a second, independent basis for the application of the doctrine of collateral estoppel.[3] (App. J166) It is a ***second*** order establishing that McCarthy is guilty of fraud or defalcation while acting in a fiduciary capacity. It is a ***second*** order that McCarthy owes Ashjian $27,493.22 plus interest at the rate of 10 percent from November 8, 1995. And while McCarthy demeans the opinion of a court-appointed arbitrator because he is not a public officer and not publicly accountable, there can be no demeaning of an opinion that has received the approval of California's ***highest*** court. (App. J166, 167)

3. Ashjian's Arbitration Brief [App. I] left little doubt that McCarthy was accused of breach of his fiduciary duty in his role as general partner (ER 00009 at line 26). The arbitrator's decision specifically noted that as the general partner he was a fiduciary and

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[1] *McCarthy On Discipline* (2002 Cal.LEXIS 8763), a copy of which is attached in the Appendix hereto.

[2] *In re Charles Connell McCarthy* (2002 Calif. Op. LEXIS 2), a copy of which is attached in the Appendix hereto.

[3] By his brief, Appellee requests this Court to augment the record appeal under FRAP 10(e).

that "Mr. McCarthy was under a continuing obligation to hold plaintiff's funds in trust and to turn them over" (ER 00011). (App. J168)

APPELLANT'S REPLY BRIEF, filed February 19, 2003 (App. K) argues, in relevant part, that:

1. The Appellee's Brief claims that "Ashjian's Arbitration Brief [App. I] left little doubt that McCarthy was accused of breach of his fiduciary duty in his role as general partner" but does not quote any particular portion of the Arbitration Brief. (Appellee's Brief, 3:5-6.) To the contrary, Ashjian's Arbitration Brief specifically admitted otherwise: "Plaintiff believed then [in July 1988], and believes now, that defendant, McCarthy has engaged in self-dealing, mismanagement, and other breaches of fiduciary duty with respect to the Kau-Kona partnership. However, for purposes of this litigation, that is ***irrelevant***." (Ashjian Arbitration Brief, 2:24-28 (ER 00009).) (App. K179)

2. Here, Ashjian explicitly conceded in his Arbitration Brief (App. I) in the underlying Municipal Court action that although he "believed then, and believes now, that defendant McCarthy has engaged in self-dealing, mismanagement, and other breaches of fiduciary duty" that "for purposes of this litigation, ***that is irrelevant***." (ER 00009.) Now, however, in the face of this prior admission (which he does not discuss in his brief even in passing). Ashjian has reversed course and now purports to argue that the purported "breach of fiduciary duty was actually decided by the arbitrator." (Appellee's Brief, 8:25-26.) Under the doctrine of judicial estoppel, because Ashjian is precluded from taking such a position, this Court should disregard such argument. (App. K187, 188)

3. In this case, Ashjian's Arbitration Brief (App. I) specifically admitted that he "believed then [in ***July 1988***] that defendant, McCarthy has engaged in self-dealing mismanagement, and other breaches of fiduciary duty with respect to the Kau-Kona partnership." (ER 00009.) Thus, Ashjian suspected that McCarthy had "done something wrong to him" more than six years before the Municipal Court complaint was filed on May 13, 1994 (ER 00001), well beyond the applicable statute of limitations (*see Cal. Code of Civil Procedure* § 338). Accordingly, Ashjian's statute of limitations to allege a breach of fiduciary duty had long expired by the time that his complaint was filed.[10] (App. K191, 192)

4. This Court recently decided the case of *Canatella v. California,* 304 F.3d 843 (9th Cir. 2002), which has been remanded to the district court for a determination whether, *inter alia*, Section 6106[11] is unconstitutional on its face for vagueness and overbreadth in violation of the First and Fourteenth Amendments of the United States Constitution. (*Canatella,* 304 F.3d at 848.) A final, retroactive determination in *Canatella* that Section 6106 is unconstitutional under federal law would obviously render null and void any discipline imposed against McCarthy. However, because Ashjian has chosen to raise the issue in this forum, McCarthy respectfully submits that this Court can and should determine whether Section 6106 is so

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[10] As noted in the Opening Brief (pages 18-19, n.10-11), Ashjian's Third Claim was denied on this very basis.

[11] California Business & Professions Code Section 6106 is the very statute McCarthy was charged with violating in his state bar disciplinary proceeding. This is the only count that had anything to do with Ashjian's claims in the instant case.

vague and overbroad on its face that it violates the United States Constitution. (App. K192, 193)

REASONS FOR GRANTING THE WRIT

The Supreme Court Of California's December 11, 2002 DECISION WITHOUT PUBLISHED OPINION and ORDER followed the precedent of *In re Rose*, 93 Cal.Rptr.2d 298 (2000), wherein the Court by separate order, denied the petition for review and imposed the discipline recommended by the State Bar Court – **without oral argument – without a *judicial* hearing – without a written *judicial* decision – and without a meaningful *judicial* review** – after deciding that:

> "We conclude that this court may summarily deny an attorney's petition for review of a State Bar Court decision recommending disbarment or suspension without violating constitutional principles." (*Id.*, 436)

There follow quotes from the cogent, insightful – indeed compelling – dissents of California Supreme Court Justices Kennard and Brown in the matter of *In re Rose*:

KENNARD, J.,

> "The majority's decision here produces a startling anomaly: Attorneys are the only persons whose state occupational licenses can be revoked or suspended without a judicial hearing. When the right to continue practicing a trade or profession is at stake, only attorneys are denied their day in court." (*Id.*, 461)

> "To summarize: The state Constitution grants litigants a right to oral argument before this

court renders a judgment, and an attorney suspension or disbarment order is a judgment rendered by this court; therefore, an attorney has a right under the state Constitution to oral argument before this court suspends or disbars the attorney." (*Id.*, 462)

"But attorneys do not have recourse to administrative mandate proceedings because their licenses are suspended or revoked not by an administrative determination, but by this court's orders. As a consequence, under the majority's decision today, only attorneys can have their licenses suspended or revoked without a *judicial* hearing and a written *judicial* decision. This disparate treatment of attorneys raises serious due process and equal protection questions. I do not address these issues, however, because I conclude that the state Constitution's oral [***79] argument and written-opinion provisions apply to attorney suspension and disbarment proceedings." (*Id.*, 465)

BROWN, J.,

"We should not, however, pretend the current legal order does not mark a transformation in the attorney discipline process, one in which a constitutional touchstone – meaningful judicial review by an article VI court – has been jettisoned." (*Id.*, 466)

"Under the new regime, attorneys penalized for professional misconduct get less in the way of genuine judicial review of discipline than licensed nonattorneys [***83] do." (*Id.*, 466)

"At the heart of the majority opinion is the supposition that review by any other name is still review and passes constitutional muster:

> that due process is satisfied by any process, however much the decisionmakers may be [**983] driven by bureaucratic agendas or political ties. In this corner of the law, at least, we seem to be presiding over a union of the legislative and judicial components of government. It may be efficient; it certainly isn't pretty. And because it seems antithetical to the constitutional design, I dissent." (*Id.*, 470)

By following the precedent of *In re Rose* (*Id.*, 436), The Supreme Court Of California intentionally refused to consider and dispose of the important federal questions presented by McCarthy's VERIFIED PETITION FOR WRIT OF REVIEW (App. E):

LEGAL DISCUSSION

I

THE STATE BAR CANNOT IDENTIFY THE FACTUAL BASIS OF A PURPORTED "MORAL TURPITUDE" VIOLATION FOR THE FIRST TIME ON APPEAL (App. E88-98)

II

THE PERIOD OF LIMITATIONS SET FORTH IN STATE BAR RULES OF PROCEDURE RULE 51 IS UNCONSTITUTIONAL (App. E 99-106)

III

A PARTY CANNOT "RATIFY" AN AGREEMENT REACHED SOLELY THROUGH COUNSEL WITHOUT "FULL KNOWLEDGE OF MATERIAL FACTS" (App. E106, 107)

The Supreme Court Of California's intentional refusal to consider and dispose of the important federal questions

presented by McCarthy's VERIFIED PETITION FOR WRIT OF REVIEW (App. E) **summarily** deprived Petitioner McCarthy of his due process and equal protection rights under the First and Fourteenth Amendments of the United States Constitution.

The Supreme Court Of California's nullification of the due process and equal protection rights under the First and Fourteenth Amendments of the United States Constitution in both *In re Rose* (*Id.*) and *In re McCarthy* (App. A) incontrovertibly confirm that The Supreme Court Of California has made a "Faustian bargain" with the California Legislature to abdicate the court's deliberative duties in all State Bar Court disciplinary proceedings, including those presenting substantial federal questions!

> "In this corner of the law, at least, we seem to be presiding over a union of the legislative and judicial components of government. It may be efficient; it certainly isn't pretty." (*In re Rose*, Brown, J., Dissenting, p. 470)

Thus, California's 167,000 attorneys are in imminent peril of being summarily deprived of their precious constitutional right to practice law by a politicized State Bar Court – **without a *judicial* hearing – without a written *judicial* decision – and without a meaningful *judicial* review** of substantial federal questions – as is their birthright as American citizens!

The same substantial federal questions presented in this matter are also presented in two matters now before the Ninth Circuit Court of Appeals: *McCarthy v. Ashjian* (App. H, J, and K); and *Canatella v. California,* 304 F.3d

843 (9th Cir. 2002). It is imperative that this Court forthwith grant McCarthy's Petition For Writ Of Certiorari to avoid contradictory decisions in these two matters!

In the circumstances of this case – it is not fair, just or equitable that The Supreme Court Of California's ORDER filed December 11, 2000 be effective until after this Court has ruled on McCarthy's Petition For Writ Of Certiorari.

Accordingly, this Court should forthwith vacate the United States District Court Order *In the Disciplinary Matter of Charles Connell McCarthy* filed April 7, 2003. (App. L)

CONCLUSION

For the foregoing reasons, this Court should forthwith grant this Petition and concurrently order that proceedings against Petitioner Charles Connell McCarthy by The Supreme Court Of California be stayed until the Supreme Court of the United States rules on Petitioner's Writ Of Certiorari; and that this Court forthwith vacate the United States District Court Order *In the Disciplinary Matter of Charles Connell McCarthy.*

Dated: May 14, 2003

Respectfully submitted,

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Admitted to the Bar of the Supreme Court on March 20, 1961

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S109242

IN THE SUPREME COURT OF CALIFORNIA

En Banc

(Filed Dec. 11, 2002)

In re CHARLES CONNELL McCARTHY on Discipline

Petition for writ of review DENIED.

It is ordered that **Charles Connell McCarthy, State bar No. 20803**, be suspended from the practice of law for four years, that execution of this suspension be stayed, and that he be placed on probation for three years on the condition that he be actually suspended from the practice of law for two years and until he makes restitution to Nazar H. Ashjian, or the Client Security Fund if it has paid, in the amount of $27,493.22, plus 10 percent simple interest per annum from November 8, 1995, until paid, and furnishes satisfactory proof thereof to the State Bar's Probation Unit in Los Angeles. McCarthy is given credit for the period of his involuntary inactive enrollment under Business and Professions Code section 6007, subdivision (c)(4) towards this recommended two-year period of actual suspension. McCarthy is also ordered to comply with the other conditions of probation recommended by the Review Department of the State Bar Court in its opinion filed April 15, 2002, as modified April 25, 2002. If McCarthy's actual suspension extends for two years or more, he shall remain suspended until he provides proof satisfactory to the State Bar Court of his rehabilitation, present fitness to practice, and present learning and ability in the general

law, in accordance with standard 1.4(c)(ii) of the Standards for Attorney Sanctions for Professional Misconduct. It is further ordered that McCarthy take and pass the Multistate Professional responsibility Examination within one year after the effective date of this order or during the period of his actual suspension, whichever is greater, and provide satisfactory proof of this passage to the State Bar's Probation Unit in Los Angeles during the same period. (See *Segretti v. State Bar* (1976) 15 Cal.3d 878, 891, fn. 8.) It is further ordered that McCarthy comply with California Rules of Court, rule 955 and that he perform the acts specified in subdivisions (a) and (c) of that rule within 30 and 40 calendar days, respectively, after the effective date of this order.* Costs are awarded to the State Bar in accordance with Business and Professions Code section 6086.10 and payable in accordance with business and Professions Code section 6140.7.

/s/ George
Chief Justice

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* (See Bus. & Prof. Code, § 6126, subd. (c).)

APPENDIX B

PUBLIC MATTER – DESIGNATED FOR PUBLICATION

REVIEW DEPARTMENT OF THE STATE BAR COURT

In the Matter of	) 96-O-00528
CHARLES CONNELL McCARTHY,	) OPINION ON REVIEW & ORDER TERMINATING INACTIVE ENROLLMENT
A Member of the State Bar.	) (Filed Apr. 15, 2002)

This matter is before this court for review because respondent Charles Connell McCarthy, general partner of Kau-Kona Land Co., a California limited partnership, (the Kau partnership, the partnership, or Kau) was found to have breached his fiduciary duties and misappropriated funds by refusing to distribute to Nazar H. Ashjian, one of the limited partners of Kau, Ashjian's portion of the preliminary distribution of Kau's funds.

The hearing judge recommended disbarment based on her findings of willful misappropriation constituting an act involving moral turpitude (Bus. & Prof. Code, § 6106)[1] and of seeking an agreement or agreeing to have a complaining witness withdraw his State Bar complaint as a condition of settlement (§ 6090.5, subd. (a)(2)).

Respondent contends that the hearing judge erroneously found culpability of the charges and requests dismissal of the entire matter.

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[1] All further references to sections are to the Business and Professions Code.

Upon our required independent review of the record (Cal. Rules of Court, rule 951.5; Rules Proc. of State Bar, rule 305(a);[2] *In re Morse* (1995) 11 Cal.4th 184, 207) and based on the applicable standards and case law, we find respondent culpable of both charges and recommend a stayed suspension of four years, a probationary period of three years, and an actual suspension of two years.

I. STATEMENT OF FACTS

Respondent was admitted to the practice of law on June 14, 1949, and has been a member of the California State Bar since that time. He has no record of prior discipline. Effective December 31, 1991, he was placed on inactive status at his request. According to respondent's exhibit A, a letter from a State Bar membership records supervisor, he returned to active status on July 6, 1999, where he remained until August 14, 2000, when he was involuntarily enrolled inactive under section 6007, subdivision (c)(4), incident to the disbarment recommendation we now review.

Procedural Background

The notice of disciplinary charges (NDC) was filed on November 24, 1999. Count one of the NDC charged respondent with violating section 6106, conduct involving moral turpitude, based on respondent's violation of his

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[2] All further references to rules are to these Rules of Procedure of the State Bar unless otherwise indicated.

fiduciary duty[3] and misappropriation of Ashjian's share of a Kau partnership distribution. Count two of the NDC charged respondent with violating section 6090.5, subdivision (a)(2), seeking an agreement to have the complaining witness, Ashjian, withdraw his State Bar complaint. Respondent filed his response to the NDC on December 30, 1999.

Respondent filed a motion to dismiss on May 30, 2000, contending that count one of the NDC should be dismissed because it failed to state a disciplinable offense (rule 262(c)(1)) and was barred by the applicable period of limitations set forth in rule 51 (rule 262(d)). The hearing judge denied the motion to dismiss, determining that count one of the NDC pleads adequate facts to state a violation of section 6106 and that the charge set forth in count one was not barred by the applicable statute of limitations due to respondent's continuing obligation to disburse the preliminary distribution funds to Ashjian.

Facts

The Partnership

On October 10, 1967, the "Agreement of Limited Partnership of Kau-Kona Land Co." (the Kau partnership agreement or the partnership agreement) was executed. It included respondent and L.M. Prince, Jr., as the only

[3] While the NDC does not specifically state that respondent breached or violated a fiduciary duty, it does specify that respondent was a fiduciary to the limited partners, and respondent himself acknowledges in his opening brief on review that he was charged with breaching his fiduciary duties to Ashjian.

general partners and Ashjian as one of the regular limited partners with an initial capital contribution of $3,000 (1 percent interest). The purpose of Kau was to purchase and hold for investment approximately 1,400 acres of land located in Hawaii. Under the partnership agreement, the regular limited partners were required to make additional capital contributions in the same proportions as their initial contributions for mortgage payments, real property taxes, and various other charges incident to real property ownership. The regular limited partners made capital contributions pursuant to the partnership agreement for approximately five or six years.

Pursuant to the partnership agreement, the general partners, in their absolute discretion, had the power, among other things, to determine whether and when to make distributions to the partners. The partnership agreement specified, however, that the general partners had no authority to do any act in contravention of the partnership agreement or of Kau's certificate of limited partnership.

Under the "Certificate of Limited Partnership of Kau-Kona Land Co.," the partnership was to continue until the earliest of the following events: (1) the sale of all partnership interest in the real property; (2) the death, adjudication of bankruptcy, insanity, or incompetency of the last surviving general partner, unless within 90 days thereafter at least 60 percent of the regular limited partnership interest elected a regular limited partner to act as general partner; or (3) October 10, 1987.

In 1971, 400 acres of the partnership's 1,400 acres of land were condemned by the State of Hawaii. Kau used the monies realized from this sale to pay off the mortgage

on the entire 1,400 acres. Thus, at that time, Kau owned the remaining 1,000 acres of land "free and clear." The partners were not called upon for further capital contributions and received a distribution in an unspecified amount at that time.[4]

In 1976, Prince breached his fiduciary duties and subsequently lost his authority to act as a general partner in 1983 by court judgement. Nonetheless, Prince retained his equity ownership in Kau.

In 1987, the partnership was extended past the October 10, 1987 termination date.

The Preliminary Distribution

In July 1986, Kau filed a voluntary petition for bankruptcy reorganization under Chapter 11 of the Bankruptcy Code (11 U.S.C. § 1101 et seq.). Kau filed its petition in the United States Bankruptcy Court for the District of Hawaii. Kau sought reorganization under Chapter 11 to prevent the foreclosure on its remaining 1,000 acres for Kau's nonpayment of water facilities charges and of a loan it obtained to purchase water rights for the property.

The bankruptcy court authorized and confirmed Kau's sale of its remaining 1,000 acres of land for $5,250,000. Thereafter, in May 1988, Kau filed a motion for order

[4] This distribution appears to have partially reimbursed the limited partners for their capital contributions. Because no issues are raised in this case pertaining to this initial distribution, we do not discuss it further.

authorizing payment of all creditors and partial disbursement to equity owners. In an order dated June 9, 1988, the bankruptcy court granted that motion and authorized Kau to pay all of its pre-petition and post-petition claims/debts. In that order, the bankruptcy court also authorized Kau to make a return of capital and a partial distribution of profits to Kau's partners in the specific amounts listed for each partner on exhibit A of Kau's motion (sometimes referred to as the preliminary distribution).

In May 1988, Kau also filed a motion to dismiss its bankruptcy proceedings. Thereafter, in an order dated July 29, 1988, the bankruptcy court found that all of Kau creditors (pre-petition and post-petition) had been paid and granted Kau's motion to dismiss. Then, in an order dated August 31, 1988, the bankruptcy court formally closed Kau's bankruptcy proceeding.

On July 27, 1988, respondent apprised each limited partner by letter that the bankruptcy court had (1) granted Kau's motion to dismiss its bankruptcy proceedings and (2) authorized him to disburse funds to each partner in accordance with the specific amounts listed for each partner on exhibit A to Kau's motion.

Even though the bankruptcy court order did not authorize him to do so, respondent conditioned this disbursement of funds to each of the partners on their executing a warranty, indemnification and release (release or release form). Specifically, respondent stated in the July 27, 1988 letter to each of Kau's partners that he "shall make distribution to you as set forth in Exhibit A of the Motion (copy enclosed), *PROVIDED* you first sign and return the enclosed [release]." The release respondent enclosed in his letter to the limited partners, among other

things, absolved respondent personally from any claims arising from his stewardship of Kau's affairs. Respondent further stated in his July 27, 1988 letter that, if the limited partner did not sign and return the release, he or she should inform respondent of the claims against him, "in which case individual distributions shall be withheld until final resolution of any dispute."

Almost all of the limited partners signed and returned the release and received their monies. Two exceptions were Ashjian and the Estate of Elinor Mayer Bryden, Decedent (the Bryden Estate). These two limited partners refused to execute the release, arguing it was improper for respondent to request that they execute a release before disbursement of their money. However, neither of these two limited partners informed respondent that they had any claims against him.

In 1989, the probate court allowed the executor of the Bryden Estate to execute the release if additional language was included in the release,[5] and the Bryden Estate thereafter received its portion of the court authorized preliminary distribution in the sum of $209,460. Ashjian insisted on a mutual release, but respondent refused to accept it, and to date, Ashjian has still not received his portion of the preliminary distribution in the sum of $20,946, which included $5,156 for a return of capital and

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[5] The additional language to be included in the warranty was set forth in the probate court's order as follows: "'Notwithstanding the foregoing it is understood and agreed that the Release shall not include or prevent any claims the undersigned Estate of ELINOR MAYER BRYDEN may have concerning or with respect to any future partnership distributions.'"

$15,790 for his share of the profit distribution. In August 1988, Ashjian signed the requested release without any modification on its face, but his attorney stated, in the cover letter accompanying the release, that the release was, in effect, mutual. Respondent refused to accept this release or disburse the $20,946 to Ashjian.

The preliminary distribution in 1988, which was made to all general and limited partners except Ashjian, left Kau with an undistributed cash balance of at least $332,055, in which sum the limited partners had a 60 percent interest and the general partner, i.e., respondent, had a 40 percent interest.[6] Respondent represented that he was holding this cash balance as a reserve to meet any contingent liabilities and obligations of the partnership.

The Final Distribution

In September 1989, respondent informed the Kau limited partners by letter that a lawsuit had been filed against CitiSavings & Loan (CitiSavings) and its attorneys on behalf of Kau; Charles McCarthy, individually; Leon Daniell, individually; and Larry Lopez, individually, for treble compensatory damages and punitive damages for bad faith dealings with the plaintiffs. Kau sought over $41,000,000 in damages. After several weeks of trial in 1990, the court dismissed the matter when the Resolution Trust Corporation (federal regulators) took over CitiSavings. However, the plaintiffs' cause of action against the

[6] Because respondent did not make the $20,946 distribution to Ashjian in accordance with the bankruptcy court's June 9, 1988 order, this amount should have been $353,001 ($332,055 plus $20,946).

attorneys for CitiSavings survived, and it settled for $1,000,000 in November 1992.

On March 30, 1993, respondent informed the Kau partners by letter that the CitiSavings attorneys' lawsuit had settled in November 1992. Kau's share of the settlement was $300,000, less $57,237.50, which was Kau's one-third share of the litigation cost, less approximately $95,000, a repayment to respondent for litigation costs advanced by respondent for about two years, and less $30,000 to be paid to respondent as compensation for making the $95,000 "nonrecourse" advance on Kau's behalf. Respondent also informed the partners that $100,000 was paid to co-plaintiff Larry Lopez, but respondent's letter was silent as to the distribution of the balance of the $600,000. We assume that $300,000 was paid to Leon Daniell[7] and $300,000 was paid to respondent, as they were represented to be plaintiffs, individually, sharing equally in the recovery proceeds and in the litigation costs. Finally, respondent stated that he was distributing $80,000 from the net proceeds to the partners as the final distribution but gave no further explanation of how he arrived at this amount of the net proceeds. Respondent made the final distribution in early 1993, and Ashjian received $480 as his proportionate share of the final distribution, without the requirement of a release.

[7] Leon Daniell and Larry Lopez were others with whom respondent was attempting to develop the Kau property.

Ashjian's Collection Attempts

After the preliminary distribution of Kau funds in 1988, Ashjian continued to demand his $20,946 share of those funds, and respondent continued to refuse to deliver the funds unless Ashjian signed the unamended release form. Ashjian received IRS Schedule K-1 forms (K-1 form), entitled "Partner's Share of Income, Credits, Deductions, etc.," throughout the life of the partnership. In 1995, the K-1 form he received showed $22,258 in his partnership capital account. For the year 1996, however, his K-1 form showed $22,258 in his capital account at the beginning of the year and nothing in his capital account at the end of the year.

In 1994, Ashjian filed a complaint in the Los Angeles Municipal Court for breach of contract and common counts against Kau, respondent in his individual capacity, and respondent's wife in her individual capacity. Said matter was ordered to arbitration, and the arbitrator awarded Ashjian damages from Kau and from respondent in the amount of $20,946, plus interest in the amount of $10,660.22, for a total of $31,606.22. The arbitrator found that there was a fiduciary relationship between respondent as the general partner and Ashjian as a limited partner of Kau and that respondent did not have the discretion or right to require Ashjian to sign a release as a precondition to receiving his share of partnership profits. The arbitrator further found that respondent was under a continuing obligation to hold Ashjian's share of funds in trust and to turn them over to Ashjian. He also found that the K-1 form provided to Ashjian in 1994 constituted an acknowledgment of indebtedness and obviated the statute of limitations issue proffered by respondent. The award

was subsequently confirmed as a municipal court judgment[8] on December 19, 1995. Thereafter, Ashjian levied on a bank account of respondent and collected $4,113.28. All other attempts to collect on the judgment were and remain unsuccessful.

On May 21, 1996, respondent filed a voluntary petition in the United States Bankruptcy Court for the Central District of California. In this petition, respondent sought to have personal debts, including Ashjian's municipal court judgment against him, discharged under Chapter 7 of the Bankruptcy Code (11 U.S.C. § 701 et seq.).

On August 22, 1996, Ashjian initiated an adversarial proceeding in respondent's personal bankruptcy to determine, as relevant here, the dischargeability of his municipal court judgment against respondent. In a memorandum of decision filed on July 29, 1997, the bankruptcy court found, among other things, that Ashjian's municipal court judgment against respondent was nondischargeable under the Bankruptcy Code. Specifically, the court found the municipal court judgment nondischargeable under 11 United States Code section 523(a)(4) because it is based on a debt that arose from a defalcation while respondent was acting in a fiduciary capacity.[9] In light of its finding that

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[8] Code of Civil Procedure section 1287.4 provides: "If an [arbitration] award is confirmed, judgment shall be entered in conformity therewith. The judgment so entered has the same force and effect as, and is subject to all the provisions of law relating to, a judgment in a civil action of the same jurisdictional classification; and it may be enforced like any other judgment of the court in which it is entered, in an action of the same jurisdictional classification."

[9] Because under California law partners are trustees (1) for each other (*Leff v. Gunter* (1983) 33 Cal.3d 508, 514) and (2) over the assets

(Continued on following page)

Ashjian's judgment was nondischargeable, the bankruptcy court entered judgment in favor of Ashjian for $27,493.22, which was the uncollected balance remaining on Ashjian's municipal court judgment of $31,606.22 after Ashjian recovered $4,113.28 by levying on respondent's bank account. The bankruptcy court also awarded Ashjian prejudgment and postjudgment interest thereon in accordance with federal law.

Respondent testified in the hearing department that the Kau partnership was dissolved in 1996 upon his filing for bankruptcy, as per the partnership agreement. However, we note that according to both the partnership agreement and the certificate of limited partnership, the partnership was dissolved when it sold the remaining 1,000 acres of its original 1,400 acres of land in Hawaii under the bankruptcy court's authorization in 1988.

Settlement Discussions as to the Bankruptcy Adversary Proceeding

During the pendency of respondent's personal bankruptcy, respondent and Ashjian engaged in negotiations regarding a possible settlement of Ashjian's adversarial

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of the partnership (*Ragsdale v. Haller* (9th Cir. 1986) 780 F.2d 794, 796), partners are fiduciaries for purposes of determining the dischargeability of a debt under 11 United States Code section 523(a)(4) (*Ragsdale v. Haller, supra,* 780 F.2d at pp. 796-797). Moreover, in the Ninth circuit, defalcation under section 523(a)(4) "'includes the innocent default of a fiduciary who fails to account fully for money received.' [Citations.] . . . An individual may be liable for defalcation without having the intent to defraud." (*Lewis v. Scott* (*In re Lewis*) (9th Cir. 1996) 97 F.3d 1182, 1186-1187, fn. omitted; *F.D.I.C. v. Jackson* (9th Cir. 1998) 133 F.3d 694, 704.)

proceeding. On March 7, 1997, James R. Felton, attorney for respondent, directed a fax and a letter to Ashjian confirming their settlement in the matter. (That letter was admitted into evidence in this proceeding as exhibit 20.) In the letter, Felton stated to Ashjian that his client (respondent) "has agreed to pay you the sum of $25,000.00 in full and complete settlement. . . . " Payment was to have been made approximately two weeks later. That letter further stated that Ashjian was to execute a full release of any and all claims against respondent and contact the State Bar to withdraw any claims, i.e., complaints, he had made. Felton further stated in his letter that a settlement agreement and mutual general release would be forwarded to Ashjian. Felton sent Ashjian a second fax and letter modifying the agreement later that same day. (That letter was admitted into evidence in this proceeding as exhibit 12.) This second letter specified that payment of $25,000 was to be made to Ashjian on or before March 20, 1997, and that the mutual general release would be signed by Ashjian, respondent, and respondent's wife. Felton explained the two letters in his letter to the State Bar dated March 25, 1997: "The first letter, faxed to [Ashjian] at approximately 9:15 a.m. that day, confirms my understanding of the terms of the settlement. The second letter, faxed to him at approximately 10:03 a.m., confirms our telephone conversation and the two changes that he requested and that Mr. McCarthy agreed to regarding the settlement."[10]

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[10] The record does not reveal the reason for the failure of this settlement. Such failure appears particularly inexplicable in view of respondent's agreement to a mutual release, which Ashjian had earlier offered but respondent had rejected.

Hearing Judge's Determination of Culpability

Based on the above, the hearing judge found respondent culpable of misappropriating Ashjian's share of the preliminary distribution, which misappropriation constituted conduct involving moral turpitude and therefore violated section 6106. She further found respondent culpable of conditioning the civil settlement agreement upon the withdrawal from the State Bar of a disciplinary complaint in violation of section 6090.5, subdivision (a)(2).

II. DISCUSSION

In this case, we must determine whether respondent is subject to discipline (1) for breaching his fiduciary duty and misappropriating funds to which Ashjian was entitled, thereby committing an act involving moral turpitude, and (2) for seeking or agreeing to Ashjian's withdrawal of his complaint to the State Bar as a condition of a settlement agreement as outlined in attorney Felton's March 7, 1997 faxes and letters to Ashjian.

Culpability as to Count One

It is well established, contrary to respondent's position, that respondent, as a general partner, owed to Ashjian, a limited partner, fiduciary obligations, including the duty of good faith and fair dealing (*Wortham & Van Liew v. Superior Court* (1987) 188 Cal.App.3d 927, 932) and that respondent was not permitted to take unfair advantage (*Cagnolatti v. Guinn* (1983) 140 Cal.App.3d 42, 48). "Partnership is a fiduciary relationship, and partners are held to the standards and duties of a trustee in their dealings with each other." (*BT-I v. Equitable Life Assurance Society* (1999) 75 Cal.App.4th 1406, 1410.) With respect to

Ashjian's share of the distribution funds, at the time such funds were distributed among the other Kau partners, respondent had a fiduciary duty to safeguard the money to which Ashjian was entitled. "An attorney who accepts the responsibility of a fiduciary nature is held to the high standards of the legal profession whether or not he acts in his capacity of an attorney. He must maintain proper books of account and records of transactions, and he may not commingle client's funds or use them for personal purposes. [Citations.]" (*Worth v. State Bar* (1976) 17 Cal.3d 337, 341.) Further, "[w]hen an attorney assumes a fiduciary relationship and violates his duty in a manner that would justify disciplinary action if the relationship had been that of attorney and client, he may properly be disciplined for his misconduct. [Citations.]" (*Clark v. State Bar* (1952) 39 Cal.2d 161, 166; *Lewis v. State Bar* (1973) 9 Cal.3d 704, 713; *In the Matter of Hultman* (Review Dept. 1995) 3 Cal. State Bar Ct. Rptr. 297, 307.) Thus, respondent is subject to discipline if he misappropriated Ashjian's share of the distribution funds or breached his fiduciary duty by failing to distribute funds to which Ashjian was entitled.

Respondent argues that he is absolved of any wrongdoing because his action is supported by Corporations Code section 15684, regarding distribution of assets, which indicates that creditors shall be paid first. However, that section is part of the California Revised Limited Partnership Act, operative July 1, 1984, and that statutory scheme is inapplicable to the Kau partnership. Instead, the provisions of the Uniform Limited Partnership Act apply to Kau. Corporations Code section 15523, part of the latter act, provides as relevant regarding the distribution of partnership assets as follows: "(1) In settling accounts

after dissolution the liabilities of the partnership shall be entitled to payment in the following order: [¶] (a) Those to creditors, in the order of priority as provided by law, except those to limited partners on account of their contributions, and to general partners, [¶] (b) Those to limited partners in respect to their share of the profits and other compensation by way of income on their contributions, [¶] (c) Those to limited partners in respect to the capital of their contributions, [¶] (d) Those to general partners other than for capital and profits, [¶] (e) Those to general partners in respect to profits, [¶] (f) Those to general partners in respect to capital."

Moreover, the partnership agreement provides, as relevant, that among partners, "[d]istributions when made . . . shall be made as hereinafter provided. [¶] A sum equal to the total of all capital contributions made by the Regular Limited Partners, without interest thereon, shall be paid to them, out of the first cash available for distribution, in the same proportions to which they made such contributions. . . . There shall be no disbursement of cash to the General Partners, or to the Special Limited Partner, until all Regular Limited Partners and/or their successor(s) in interest, have been paid sums equal to the total of all their capital contributions as hereinabove provided."

Thus, the applicable statute, as well as the provisions of the partnership agreement, provide that limited partners are to receive their capital contributions before a general partner receives a share of the profits. In addition, the statute provides that limited partners are to receive both capital contributions and profits before a general partner receives profits. Here, contrary to the applicable statute and the partnership agreement, respondent received his share of profits in two different distributions

without having first distributed to Ashjian his capital contribution and share of profits. We therefore conclude that respondent breached his fiduciary duty to Ashjian.

We additionally determine that the evidence establishes that respondent misappropriated funds which Ashjian was entitled to receive. In *Edwards v. State Bar* (1990) 52 Cal.3d 28, 36-37, misappropriation was found based on evidence that the attorney withdrew a client's funds from his trust account and spent such funds for his own benefit without his client's authorization. In *Baca v. State Bar* (1990) 52 Cal.3d 294, 304, the court held that "an attorney's failure to use entrusted funds for the purpose for which they were entrusted constitutes misappropriation. [Citation.]" In *Brody v. State Bar* (1974) 11 Cal.3d 347, 349-350, the attorney was found culpable of commingling client funds with his own and misappropriating client funds to his own use. The attorney argued that due to an inadvertent mathematical error, he had been unaware of any financial obligation to his client, and therefore he was not culpable of willful misappropriation. (*Id.* at p. 350.) The Supreme Court found, however, that evidence of Brody's persistent refusal to account to his client in the face of repeated demands to do so justified the finding of willful misappropriation. (*Ibid.*)

In each of the above cases, the conclusion that misappropriation occurred was based upon a finding that the attorney utilized client funds for his own use. In the present case, as we will discuss, we conclude (1) that Ashjian was entitled to receive his share of the preliminary distribution funds, whether or not he was entitled to receive them at the time of the preliminary distribution in

1988, and (2) that respondent committed a misappropriation by taking Ashjian's share of those funds for his own use.

The record reflects that in 1988, when the preliminary distribution was announced by the general partner and all limited partners were informed of their respective shares of the distribution, each partner's share was earmarked and recorded in an individual account. The record additionally reflects that respondent, as general partner, took his portion of the preliminary distribution of profits of over $1 million dollars without having paid Ashjian his $20,946 share.

Even assuming, without deciding, that respondent was entitled to retain Ashjian's share of funds at the time of the preliminary distribution in 1988 because Ashjian did not execute the release which respondent requested, then at the very least, respondent was required to disburse to Ashjian his $20,946 share of the preliminary distribution no later than early 1993, when respondent made the final distribution. At that time, respondent disbursed all remaining partnership funds without requiring any release, and he should therefore have been able to release all of the funds to which Ashjian was entitled at that time. Instead, respondent disbursed to Ashjian only his $480 share of the final distribution and still took his own $22,400 share of the final distribution. Because respondent was not entitled to take his share of the final distribution before paying Ashjian his capital contribution and profits, respondent effectively took Ashjian's $20,946

share of the preliminary distribution for his own use no later than this time.[11]

However, we need not and do not decide in this case whether the funds which respondent took belonged to Ashjian or to Kau, as it is clear that respondent took funds he did not own and to which Ashjian was entitled. Because the evidence establishes that respondent took his share of the final distribution without ever having paid Ashjian his share of the preliminary distribution, we conclude that at the time of the final disbursement, at the very latest, respondent was culpable of willfully misappropriating funds to which Ashjian was entitled.

To support his assertion that he was entitled to take his share of the preliminary distribution before disbursing Ashjian's share, in his reply brief respondent points to the provision of the partnership agreement that allows the

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[11] *Fretz v. Burke* (1967) 247 Cal.App.2d 741, discussed the propriety of a general partner holding certain limited partners' share of profits in a suspense account, although distribution of profits had been made to other limited partners. A preliminary injunction was obtained by the limited partners requiring the general partner to disburse their share of profits to them. In holding the injunction to be proper, the appellate court held (1) that the injunction "simply directs that the part *which belongs to [the limited partners]* shall be paid to them now, and shall not be held by [the general partner] in suspense;" (2) that the injunction "merely prevents [the general partner] from putting funds *which belong to [the limited partners]* into a suspense account, purportedly as security for possible costs, a security which the law does not allow him;" and (3) that the injunction corrected "an overbearing assumption by [the general partner] of superiority and domination over *the rights and property of [the limited partners].*" (*Id.* at pp. 745-746, italics added.) We look to *Fretz v. Burke, supra,* only as support for our conclusion that, regardless of who owned the funds, Ashjian was entitled to receive them.

general partners a disbursement of 50 percent of their portion of the cash and 25 percent of their portion of the capital gain income for federal income tax purposes.[12] However, there is no evidence that respondent, as general partner, received only 50 percent of the cash and 25 percent of the capital gain income and only for income tax purposes. Instead, as indicated, the evidence shows that respondent received his portion of the preliminary distribution but did not disburse to Ashjian his portion of this distribution at any time.

Notwithstanding respondent's assertion, noted above, that he simply used Ashjian's share of the preliminary distribution to pay creditors first, as required under the Corporations Code, respondent has nevertheless failed to explain why he took his own share of the preliminary and final distribution before disbursing Ashjian's share of the preliminary distribution. In arguing the propriety of paying creditors of the partnership, respondent misses the point. As discussed, respondent was not entitled to take his share of partnership profits until after Ashjian had been paid, and by taking his share of distribution funds first, respondent used Ashjian's share to pay himself. This

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[12] The partnership agreement provides as relevant: "If prior to payment of the Regular Limited Partners, of sums equal to the full amounts of their contributions to capital, ordinary income or capital gain income, as defined for federal income tax purposes, is attributable to the General Partners and Special Limited Partner as of the end of any tax year, then notwithstanding the foregoing, General Partners and Special Limited Partner shall be entitled to a disbursement of cash equal to 50% of any such ordinary income and 25% of any such capital gain income, less 50% of any cummulative [sic] loss attributable to them."

payment to respondent prior to payment to Ashjian constituted a misappropriation of Ashjian's share of distribution funds.

Respondent relies on *Wyler v. Feuer* (1978) 85 Cal.App.3d 392, 402-403; *Wallner v. Parry Professional Bldg., Ltd.* (1994) 22 Cal.App.4th 1446, 1451, fn. 6; and *Baldwin v. Marina City Properties, Inc.* (1978) 79 Cal.App.3d 393, 411, to support his position that requiring the release before distribution was a discretionary act made in the exercise of his honest business judgment as general partner. However, in each of these cases the discussion of a general partner's exercise of business judgment pertained to the general partner's liability for business losses sustained in managing the partnership's businesses. In the present case, we are not concerned with respondent's management of the partnership and partnership funds. Rather, this case involves respondent's ethical duties as an attorney when acting as a general partner and payment to himself of funds which, at least at the time of the final distribution, a limited partner was entitled to receive. Moreover, respondent's decision to require the limited partners to execute a release as a condition of distribution was not a decision made purely in the exercise of his honest business judgment in managing the partnership. Instead, the release was intended to exonerate respondent personally, not just the partnership, from all liabilities. Therefore, respondent cannot escape responsibility by claiming he was simply carrying on the business of the partnership when he sought to condition the preliminary distribution on the execution of the releases by the limited partners.

We also conclude that this willful misappropriation and violation of respondent's fiduciary duties to Ashjian

involved moral turpitude. In *Johnstone v. State Bar* (1966) 64 Cal.2d 153, the Supreme Court found moral turpitude under similar circumstances. There, Johnstone negotiated a $3,000 settlement for personal injuries his client suffered in an industrial accident. As part of the settlement, Industrial Indemnity Company (Industrial) agreed to accept $1,000 of the $3,000 settlement funds from the third-party tortfeasor in place of its workers' compensation benefit lien in the amount of $4,945.57. (*Id.* at pp. 154-155.) After Johnstone deposited the settlement funds in his trust account, he delivered to Industrial a $1,000 check drawn on his trust account, but the check was returned by the bank for insufficient funds. Johnstone never paid Industrial the money to which it was entitled. (*Id.* at p. 155.) The Supreme Court determined that Johnstone held the money in trust for Industrial, that Johnstone breached that trust by failing to pay such money to Industrial and instead taking the money for his own use, and that such breach was an act involving moral turpitude: "The wilful violation of [the] trust herein, as found by the [State Bar], clearly constitutes an act involving moral turpitude and dishonesty within the meaning of section 6106 of the Business and Professions Code, as that section has been applied even in the absence of an attorney-client relationship." (*Id.* at p. 156, fn. omitted.)

Similarly, respondent's misappropriation of Ashjian's share of the distribution funds in this case, which act was also a breach of respondent's fiduciary duties to Ashjian, constituted an act involving moral turpitude. In sum, upon our independent review, we conclude that the State Bar has proved respondent culpable of violating of section 6106 by clear and convincing evidence.

Respondent's Contentions on Review as to Count One[13]

Motion to Dismiss Count One

In his opening brief on review, respondent asserts that the hearing judge erred in denying his motion to dismiss count one of the NDC and argues that the review department should now correct that error by dismissing count one. In requesting such dismissal, respondent repeats his arguments that: (1) the NDC failed to allege specific facts in support of the charge set forth in count one; (2) respondent was entitled to rely upon a probate court order approving of respondent's requirement that the Kau limited partners sign a release prior to receiving their respective shares of the preliminary distribution; (3) the NDC relied upon an underlying municipal court judgment that is void; and (4) the NDC was barred by the applicable period of limitations.

Respondent brought his motion to dismiss under rule 262(c) and (d). Rule 262(c)(1) provides as relevant that "[a] proceeding may be dismissed . . . for failure of the initial pleading to state a disciplinable offense. . . . " Rule 262(d) provides that "[a] proceeding may be dismissed on the ground that it is barred by any applicable statute or rule."

As previously indicated, all of respondent's arguments set forth in the motion to dismiss, except the argument based on the period of limitations, were encompassed within his contention that the NDC was defective because

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[13] We address respondent's principal points of error on review. Any points of error or supporting arguments that are not expressly addressed in this opinion have been considered and rejected.

it failed to state a disciplinable offense. In reviewing such a contention, "we treat the factual allegations of the notice as true, but draw our own independent conclusions regarding the legal import of those facts. [Citations.]" (*In the Matter of Tady* (Review Dept.1992) 2 Cal. State Bar Ct. Rptr. 121, 124.)[14] "Both at hearing and on review, the court considering a motion to dismiss of this type should disregard all factual matters outside the ambit of the notice . . . , since *the purpose of the motion is to test the sufficiency of the notice, not to contest the charges.* [Citation.] However, judicially noticeable facts outside the scope of the notice are an exception to this rule, and are cognizable. [Citations.]" (*Ibid.*, italics added.)

Respondent never explained, and we fail to understand, how the probate court order and the municipal court judgment result in the failure of the NDC to state a disciplinable offense. In making these arguments, rather than presenting grounds for dismissal as a result of the insufficiency of count one, respondent is contesting the substance of the charges and apparently requesting a sort of pretrial summary judgment. (See Code Civ. Proc., § 437c.) However, no such procedure is available in State Bar disciplinary proceedings. "Assuming the notice . . . properly charges a disciplinable offense, the appropriate time for respondent to present evidence in defense or mitigation [is] at the hearing on the merits. . . . " (*In the Matter of Tady, supra,* 2 Cal. State Bar Ct. Rptr. at p. 125.)

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[14] We note that *In the Matter of Tady, supra,* 2 Cal. State Bar Ct. Rptr. 121, was decided before the effective date of rule 260 and so does not affect our interpretation of rule 260(d).

We therefore conclude that respondent's assertions as to these matters did not warrant pretrial dismissal.

As to the general question of whether count one states a disciplinable offense, we note that respondent was charged in that count with violating section 6106. That section provides in relevant part that "[t]he commission of any act involving moral turpitude, dishonesty or corruption, whether the act is committed in the course of his relations as an attorney or otherwise, and whether the act is a felony or misdemeanor or not, constitutes a cause for disbarment or suspension." Respondent was specifically charged with violating section 6106 by misappropriating funds to which Ashjian was entitled. Moreover, as noted above in footnote 3, we conclude that the NDC adequately charged respondent with violating his fiduciary duties to Ashjian.

We have already discussed that respondent, as a general partner, had a fiduciary duty to Ashjian and was statutorily required, upon the dissolution of the partnership, to pay Ashjian his share of capital contributions and partnership profits before respondent took his own share of profits. (*Wortham & Van Liew v. Superior Court, supra,* 188 Cal.App.3d at p. 932; Corp. Code, § 15523.) As we have also discussed, respondent, having accepted fiduciary responsibilities, "is still held to the same fiduciary duties . . . as if there were an attorney-client relationship. [Citations.]" (*In the Matter of Lilly* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 185, 191.) A breach of such fiduciary responsibilities can constitute an act involving moral turpitude where such breach involves more than simple negligence. (*Ibid; In the Matter of Hagen* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 153, 169.)

As to the charge that respondent misappropriated funds, the terms "misappropriation" and "willful misappropriation" are often used interchangeably, and neither of them appear in either the Rules of Professional Conduct or the State Bar Act. These terms are defined by many court decisions, as we have discussed *ante,* which have held that the terms cover a wide range of conduct involving the conversion of client or other trust funds. (See *Edwards v. State Bar, supra,* 52 Cal.3d at p. 38.) When an attorney's misappropriation involves at least gross carelessness or gross negligence, the misappropriation involves moral turpitude. (*Lipson v. State Bar* (1991) 53 Cal.3d 1010, 1020-1021.) Moreover, " '[t]he fact that the balance in an attorney's trust account has fallen below the amount due his client will support a finding of wilful misappropriation.' [Citation.]" (*Id.* at p. 1020.)

In summary, count one of the NDC alleged that respondent, as general partner of Kau having a fiduciary duty to Ashjian, a limited partner, made preliminary distributions of partnership profits in July 1988; that Ashjian's share of this preliminary distribution was $20,946; and that because Ashjian refused to sign the release of liability which respondent requested prior to making the preliminary distribution, respondent refused to disburse Ashjian's share. Count one further alleged that despite Ashjian's repeated requests for the funds, respondent never released the funds to Ashjian and informed Ashjian in or about January 1997 that he no longer had the funds. These allegations were sufficient to state a disciplinary offense: by failing to distribute to Ashjian his share of the preliminary distribution funds, respondent

breached his fiduciary duty to Ashjian and misappropriated funds to which Ashjian was entitled, and such conduct constituted an act of moral turpitude.[15]

As to the assertion that the NDC was barred by the applicable period of limitations, respondent relies upon rule 51(a). That rule provides: "A disciplinary proceeding based solely on a complainant's allegation of a violation of the State Bar Act or Rules of Professional Conduct shall be initiated within five years from the date of the alleged violation." Rule 51(b) goes on to provide: "For purposes of paragraph (a) of the rule, a violation of the State Bar Act or the Rules of Professional Conduct is deemed to have been committed when every element of the alleged violation has occurred, except where the alleged violation is a continuing offense, in which case the violation is deemed to have been committed at the termination of the entire course of conduct." Moreover, rule 51(c)(4) provides that the five-year limitations period in rule 51(a) is tolled during the time that "[t]he member conceals facts constituting the violation." The State Bar does not dispute, and

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[15] In some respects respondent's arguments in both the motion to dismiss and his opening brief on review appear to involve arguments regarding insufficient notice of the charge set forth in count one. To the extent that respondent attempts to make such an assertion, however, such assertion was required to be made "no later than the date on which the moving party's response is to be filed, or, if no response is provided for, no later than twenty (20) days after the service of the initial pleading." (Rule 262(c)(2).) Because respondent's motion to dismiss was filed later than the date his response to the NDC was due, however, the assertion was waived as a basis for dismissal of the charge in count one. (Rule 262(c)(2) ["Failure to file a timely motion under this subparagraph shall preclude the party from a later assertion of the alleged inadequate notice of the charges as a ground for dismissal of the proceeding. . . ."].)

we agree, that rule 51(a) applies in this case. The State Bar argues, however, that the five-year limitations period was tolled for various reasons.

We need not address each of the reasons for tolling advanced by the State Bar. As already indicated, in reviewing a pretrial motion to dismiss, we treat the factual allegations of the NDC as true. (*In the Matter of Tady, supra,* 2 Cal. State Bar Ct. Rptr. at p. 124.) According to these allegations, respondent did not inform Ashjian that Ashjian's share of the preliminary distribution funds were gone until approximately January 1997. Under these facts, either the funds were not gone, and therefore the charged breach of fiduciary duty and misappropriation did not occur, or continued, until that date, or respondent concealed the breach of fiduciary duty and misappropriation until that date. Either way, under rule 51, the five-year limitations period did not commence to run until that date. Therefore, the NDC, filed on November 24, 1999, was timely.

Respondent's argument that the NDC was untimely is based upon his incorrect assertion that the moral turpitude charge arose from respondent's alleged breach of fiduciary duty occurring in 1988, when respondent initially refused to distribute Ashjian's funds until Ashjian signed the release.[16] However, while the NDC refers to the

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[16] We note additionally that in his opening brief, respondent erroneously relies upon his trial testimony in arguing that Ashjian's funds were "exhausted as of early 1993" and that therefore the charged breach of fiduciary duty and misappropriation occurred more than five years before the NDC was filed. However, as indicated, the NDC alleges that the relevant breach of fiduciary duty and misappropriation

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1988 date, the NDC specifies that the moral turpitude charge is based upon respondent's breach of fiduciary duty and misappropriation resulting not only from his initial failure, but from his ultimate failure to distribute the preliminary distribution funds, even after Ashjian obtained with respect to these funds a municipal court judgment and a bankruptcy court finding of nondischargeability of the judgment.

Motion to Dismiss for Failure to Meet Burden of Proof

Respondent next contends that the hearing judge erroneously denied his motion brought pursuant to rule 219. Rule 219(a) provides as relevant that "[d]uring a trial, after the party with the burden of proof has rested, and before the proceeding is taken under submission by the Court, an opposing party may make an oral or written motion for a determination that the party with the burden of proof has failed to meet that burden. . . . " Rule 219(b) provides that in ruling upon such a motion, the court is to "consider all of the evidence introduced, weigh the evidence and make determinations of credibility." We apply a de novo standard of review to a hearing judge's ruling on a rule 219 motion. That is, "[b]ased upon our independent review of the evidence before the hearing judge at the time the motion was made, we must determine whether clear and convincing evidence was presented of each element of the charged offenses. In deciding these issues, we must

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occurred or continued after that date, or at least that respondent concealed such misconduct until a later date.

give great weight to the hearing judge's credibility determinations. [Citation.]" (*In the Matter of Chesnut* (2000) 4 Cal. State Bar Ct. Rptr. 166, 171.)

We note briefly that our conclusion regarding respondent's culpability as to count one, discussed previously, was based upon evidence presented in the State Bar's case-in-chief. Thus, the evidence in the record at the time respondent made his motion established respondent's culpability under count one.

As to this motion, respondent specifically argues in his brief on review with respect to count one that (1) respondent cannot be found culpable of an act involving moral turpitude because his actions were based upon his exercise of reasonable business judgment; (2) the State Bar failed to establish that respondent took Kau money and used it for his personal gain; and (3) respondent's conduct did not rise to the level of moral turpitude.

As we discussed in determining culpability, we are not concerned with respondent's management of the affairs of the partnership but with respondent's ethical duties as an attorney acting as a general partner. Thus, we reject respondent's arguments regarding his exercise of reasonable business judgment.

We also reject respondent's next argument, that the State Bar failed to produce any evidence establishing that he took Kau money and used it for his personal gain. As we previously discussed in determining respondent's culpability as to count one, although respondent relies upon Corporations Code section 15684 to support his use of Ashjian's $20,946 share of the preliminary distribution funds to pay creditors, respondent has failed to explain why, at the time of the final distribution, when respondent

no longer required a release, respondent failed to disburse Ashjian's share of the preliminary distribution but nevertheless took his own share of the final distribution. This payment to himself, a general partner, prior to payment of a limited partner violated both the applicable Corporations Code section and the partnership agreement and constituted a breach of fiduciary duty and a misappropriation of Ashjian's share of the funds for respondent's own use.

In our discussion of culpability as to count one, we have already resolved adversely to respondent his assertion that his conduct did not rise to the level of moral turpitude. In the cases upon which respondent relies, the attorneys were impliedly found not to have acted intentionally or with gross negligence, and therefore no moral turpitude was involved. Here, as we have indicated, we find, consistent with the hearing judge's finding, that respondent's use of Ashjian's share of the preliminary distribution funds to benefit himself involved moral turpitude, as it resulted from at least grossly negligent conduct.

Hearing Judge's Culpability Findings After Trial

Respondent next contends with respect to count one that in finding him culpable after trial, the hearing judge erred in (1) determining that the funds earmarked for Ashjian at the time of the preliminary distribution became Ashjian's funds; (2) determining that respondent breached his fiduciary duty to Ashjian by requiring a release from all limited partners before disbursing funds pursuant to the preliminary distribution; (3) assuring respondent that his plan for preliminary distribution was proper, then

concluding otherwise in the decision; (4) applying the doctrine of collateral estoppel and ignoring the State Bar's heavier burden of proof in disciplinary proceedings; (5) refusing to consider respondent's defense that he relied upon the advice of counsel regarding the propriety of the release and Ashjian's refusal to sign it; and (6) determining that respondent concealed the absence of Ashjian's share of the preliminary distribution funds by sending Ashjian K-1 forms reflecting that his share of the funds were available.

With respect to respondent's first two contentions, upon this independent review, we need not determine whether the funds earmarked for Ashjian at the time of the preliminary distribution became Ashjian's funds or whether respondent breached his fiduciary duty to Ashjian by requiring a release from all limited partners before disbursing funds pursuant to the preliminary distribution plan. As we have stated, even assuming for the sake of argument that respondent was entitled to withhold the funds at the time of the preliminary distribution due to Ashjian's refusal to sign the release, respondent was precluded from receiving respondent's share of profits at the time of the final distribution, when no release was required for disbursal of funds, prior to disbursing Ashjian's share of distribution funds. Moreover, regardless of whether Ashjian or Kau owned the funds earmarked for Ashjian at the time of the preliminary distribution, it is clear that respondent did not own the funds, and respondent was statutorily required to pay the $20,946 to Ashjian at the time the partnership was dissolved and before taking his own share of the final distribution. Because respondent paid to himself funds that should have been

paid to Ashjian, respondent breached his fiduciary duties to Ashjian and misappropriated the funds.

Moreover, with respect to the hearing judge's assurances that respondent's plan for preliminary distribution was proper, it appears from the record that the hearing judge was merely stating that no one was challenging respondent's decision to preliminarily distribute funds to the partners, the fairness of the amounts distributed, or the way respondent ran the partnership in general. Each time the hearing judge made these assurances, however, she correctly added that the issues being questioned were respondent's failure to disburse Ashjian's share of the preliminary distribution and possibly the requirement of a release prior to making this distribution.[17] In making each of the statements to which respondent refers, the hearing judge was appropriately attempting to expedite the trial proceedings by excluding evidence which was only marginally relevant to the issues raised in this case. (See Evid. Code, § 352; *People v. Hart* (1999) 20 Cal.4th 546, 607 [a court has discretion to exclude evidence on collateral matters].) We conclude that the hearing judge's statements to respondent during trial were correct and cannot have misled respondent into believing he did not need to explain the actions he took which are at issue in this case.

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[17] As previously indicated, we need not resolve in this case the propriety of respondent's requirement of a release at the time of the preliminary distribution, since we have concluded that, even if it were proper, respondent could not continue to withhold the preliminary distribution funds from Ashjian at the time of the final distribution, when respondent no longer required any release prior to disbursing funds.

We disagree with respondent's statement that the "inescapable inference" from the record is that the hearing judge applied the doctrine of collateral estoppel in this case, giving preclusive effect to the municipal court judgment and ignoring the State Bar's heavier burden of proof in disciplinary proceedings. Rather, because the hearing judge never stated she was applying the doctrine of collateral estoppel or indicated in the decision that she was in any way bound by the municipal court judgment, we decline to interpret her statement in the decision as an application of collateral estoppel. In such statement, the hearing judge specifically ruled that the release requirement was improper "in the court's view," and only parenthetically noted that the arbitrator in the municipal court action held the same view. We therefore find no error in this respect. In any event, we have not applied collateral estoppel in our de novo review.

Respondent also asserts that the hearing judge erroneously refused to consider his defense that he relied upon the advice of counsel regarding the propriety of the release and Ashjian's refusal to sign it. However, because, as we have discussed, we need not decide in this case whether requiring a release at the time of the preliminary distribution was appropriate, we need not determine whether the hearing judge should have allowed respondent's attorney to testify regarding this advice to respondent.[18]

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[18] We note additionally that the record does not establish that respondent made an offer of proof in order to give the hearing judge notice of the substance, purpose, and relevance of the proposed

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Respondent's final contention in his opening brief is that the hearing judge erred in determining that respondent concealed the absence of Ashjian's share of the preliminary distribution funds by sending Ashjian K-1 forms reflecting that the funds were available. Respondent argues in his reply brief that because (1) the K-1 form is simply an accounting tool and (2) Ashjian testified that he understood that a capital account does not necessarily represent cash, the K-1 forms could not have misled Ashjian regarding the availability of the preliminary distribution funds. Respondent's arguments in this respect are essentially that, based on the evidence presented at trial, these disciplinary proceedings were barred by the period of limitations. As we previously stated, the hearing judge determined that respondent concealed the breach of fiduciary duty and misappropriation until 1996 by issuing to Ashjian K-1 tax forms which showed an amount equal to Ashjian's share of the preliminary distribution funds in Ashjian's capital account until the year 1995. The 1996 K-1 form showed for the first time a zero balance in Ashjian's capital account.

Respondent argues as to this issue that the hearing judge's determination set forth above "appears particularly far fetched and unsupported by any evidence," that "this inference from the evidence presented is simply not reasonable," and that "the only reasonable . . . explanation for the 1996 K1" is that the1996 K-1 simply reflected "an 'accounting decision' that any positive capital accounts would be reduced to zero and show an ordinary loss that

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testimony. (See Evid. Code, § 354.) Accordingly, respondent has waived any error.

could be used as a deduction." However, we disagree with respondent's characterization of the hearing judge's determination and agree with the hearing judge's interpretation of the evidence.

As we found, Ashjian received K-1 forms throughout the life of the partnership. His 1995 K-1 form showed $22,258 in his partnership capital account, and his 1996 K-1 form showed $22,258 in his capital account at the beginning of the year but nothing at the end of the year. Respondent gave no explanation as to why the accountant would continue to send the K-1 forms through these years and then suddenly show "0" at the end of the year in 1996, except to say that it was a joint decision of respondent and the accountant and that it occurred in 1996 because Kau had no further assets, and Ashjian could use the loss as a deduction. Respondent testified that Ashjian's share of the preliminary distribution had remained in the general account and that the general account had been depleted in 1993 for litigation costs, but there is no evidence showing that Ashjian knew of this alleged fact. On May 11, 1993, respondent's attorney wrote to Ashjian's attorney and stated in reference to the settlement of CitiSavings lawsuit: "With the settlement of this lawsuit, all of the business and affairs of the Kau Partnership have been completed." Respondent argued earlier in his opening brief on review that this statement should have alerted Ashjian at that time that the partnership had no assets. Alternatively, respondent argues that Ashjian "was on notice of his claim as early as August 1988" when respondent informed the partners that they must sign a release in order to receive their shares of the preliminary distribution.

However, we agree with the hearing judge's conclusion that in providing the K-1 forms to Ashjian through 1996, respondent concealed from Ashjian the availability of funds remaining in Kau and, consequently, respondent's misappropriation of Ashjian's share of the preliminary distribution funds. It is clear that on March 30, 1993, there were sufficient funds in the partnership account from the CitiSavings settlement to pay Ashjian his $20,946, but respondent chose to pay himself and the other limited partners, depleting all of the funds available to pay Ashjian.[19] We determine that this concealment of respondent's breach of fiduciary duty and misappropriation is the more reasonable explanation for additional K-1 forms showing funds in Ashjian's capital account after the time of the final distribution.

Respondent additionally argues in his reply brief that he cannot be found culpable of moral turpitude as set forth in count one because he was entitled to rely upon a probate court order approving of the requirement that the Kau limited partners sign a release prior to receiving their respective shares of the preliminary distribution. However, because we need not address the propriety of the release in this case, we do not further address this issue.

Culpability as to Count Two

Respondent contends that the State Bar failed to prove that he is culpable of conditioning settlement on the withdrawal of Ashjian's complaint from the State Bar, and

[19] As we previously indicated, respondent testified at the trial in this matter that all partnership funds had been depleted by 1993.

therefore this charge should be dismissed. He argues that he was not in direct contact with Ashjian and that his attorney discussed the withdrawal of the State Bar complaint without his knowledge. The hearing judge found this to be incredible and found that respondent, at the least, ratified his attorney's position as to the proposed settlement, since he was more than aware of the complaint filed by Ashjian. We give substantial weight to the credibility determinations made by the hearing judge, who saw and heard the parties testify. (Rule 305(a) [review department gives great weight to hearing judge's findings resolving issues of credibility]; *Franklin v. State Bar* (1986) 41 Cal.3d 700, 708.)

Section 6090.5, subdivision (a), provides that it is a disciplinable offense for an attorney "to agree or seek agreement" that "[t]he plaintiff shall withdraw a disciplinary complaint" from the State Bar. While the record reflects that respondent's attorney handled the settlement negotiations with Ashjian in the bankruptcy adversarial proceeding, respondent acknowledged, while testifying at trial in this matter, that he received copies of the letters his attorney sent to Ashjian and was on notice that one term of the proposed settlement was that Ashjian withdraw his State Bar complaint. Moreover, in his letter to the State Bar dated March 25, 1997, respondent's attorney, Felton, indicated that respondent had specifically agreed to the terms of the settlement set forth in Felton's second letter to Ashjian dated March 7, 1997. Although respondent asserted during his trial testimony that in his view, the withdrawal of the State Bar complaint was not a condition of the settlement, in his declaration in the bankruptcy court dated July 15, 1997, respondent stated

that the withdrawal of the State Bar complaint was one of the terms of settlement.

Respondent asserts that his attorney had no authority to discuss the withdrawal of Ashjian's State Bar complaint and that he never ratified his attorney's unauthorized settlement negotiations. First, however, as we noted above, Felton's letter to the State Bar indicates that respondent himself agreed to all terms of the settlement, including the term that Ashjian withdraw his complaint to the State Bar. Second, "[a]s a general proposition . . . 'the client as principal is bound by the acts of the attorney-agent within the scope of . . . his apparent or ostensible authority. . . . ' [Citations.]" (*Blanton v. Womancare, Inc.* (1985) 38 Cal.3d 396, 403.) Ostensible authority can include "such authority as the *principal,* either intentionally or by want of ordinary care, causes or allows a *third person* to believe the agent possesses. [Citations.]" (2 Witkin, Summary of Cal. Law (9th ed. 1987) Agency and Employment, § 93, p. 92, original italics; *Thompson v. Occidental Life Ins. Co.* (1973) 9 Cal.3d 904, 913-914.) Here, respondent admitted at trial that upon receiving notice that his attorney had discussed Ashjian's withdrawal of his complaint to the State Bar, respondent did nothing to inform either his counsel or Ashjian that his counsel lacked authority to discuss such a settlement term on his behalf. In view of respondent's failure to take any action, we conclude that respondent's attorney had apparent authority to enter into such settlement discussions for respondent.[20]

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[20] Concurrently with the filing of this opinion, we refer to the Office of the Chief Trial Counsel of the State Bar for appropriate investigation and action the issue of respondent's counsel's conduct in negotiating

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Respondent also asserts that he relied in good faith upon the advice of his counsel, which reliance constitutes a defense to the charge in count two. Respondent cites *Kaplan v. State Bar* (1991) 52 Cal.3d 1067 (*Kaplan*). There, upon Kaplan's misappropriation of funds which Kaplan's firm held for a client in bankruptcy, the Hearing Panel of the State Bar Court found a trust account violation under former rule 8-101(A) of the Rules of Professional Conduct but did not find that the misappropriation involved moral turpitude. This refusal to find moral turpitude was based on the facts that the fees had been earned by the firm, that Kaplan did not realize that the bankruptcy court had to approve the withdrawal of the earned fees, and that an experienced bankruptcy attorney had told Kaplan that the funds were available for withdrawal. (*Id.* at p. 1070 & fn. 3.)

Respondent's reliance on *Kaplan* is misplaced. First, *Kaplan* demonstrates that reliance on counsel is not a complete defense to a charge, as Kaplan was still found culpable of failing to maintain client funds in a client trust account. Second, there is no evidence in the present case that respondent's attorney was experienced in disciplinary matters, such that respondent could reasonably rely upon his expertise regarding the propriety of agreeing to a withdrawal of a complaint to the State Bar. Finally, there is no evidence here that respondent had any discussion with his attorney regarding the propriety of such an agreement; therefore, respondent cannot be deemed to have relied upon counsel.

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this settlement for respondent. (See rule 218; *In the Matter of Respondent X* (Review Dept. 1997) 3 Cal. State Bar Ct. Rptr. 592, 595, fn. 6.)

Respondent's final assertion with respect to count two is that there was neither evidence nor a finding below that he willfully violated section 6090.5 as charged in the NDC. Because we have concluded, based on our de novo review of the evidence, that respondent intended to agree to Ashjian's withdrawal of his State Bar complaint as a term of the civil settlement agreement, we find that respondent's violation was willful, "even applying the somewhat more specific level of wilfulness required for violations of the State Bar Act, as opposed to violations of the Rules of Professional Conduct. [Citations.]" (*In the Matter of Respondent X, supra,* 3 Cal. State Bar Ct. Rptr. at p. 603.)

In sum, our independent review of the facts leads us to conclude that clear and convincing evidence establishes respondent's culpability of willfully violating section 6090.5.

III. DISCIPLINE

To properly assess the discipline to be recommended, we must first consider evidence in mitigation and in aggravation.

Mitigating Factors

The hearing judge found respondent's long and unblemished career to be a strong mitigating factor. (Rules Proc. of State Bar, tit. IV, Stds. for Atty. Sanctions for Prof. Misconduct (standards), std. 1.2(e)(i).) We agree. Further, the hearing judge found the character testimony of two associates and respondent's wife to be mitigating factors but did not find this evidence to be an extraordinary demonstration of good character. (Std.1.2(e)(vi).) We also so find.

Respondent additionally presented evidence of community service activities, which are to be considered as mitigating circumstances. (*In the Matter of Spaith* (Review Dept. 1996) 3 Cal. State Bar Ct. Rptr. 511, 521.)

Also in mitigation, respondent presented evidence that before requiring the signing of the release as a condition of receiving preliminary distribution funds, he consulted a financial manager, who advised him that requiring a release before distributing the funds was proper. We find respondent's good faith action under these circumstances to be a mitigating factor (std.1.2(e)(ii)), although we give such mitigation very little weight in view of the fact that we did not determine whether the requirement of the release by respondent was improper.

However, respondent's claim in mitigation that he acted in good faith toward Ashjian is unpersuasive. His refusal to resolve the issue, even after the apparent settlement of March 7, 1997, is proof that respondent, for whatever reason, had no intention of delivering Ashjian's $20,946 share of the preliminary distribution funds to him.

Aggravating Factors

In aggravation, we find, as did the hearing judge, that respondent's conduct was surrounded by concealment. (Std.1.2(b)(iii).) By providing Ashjian with K-1 forms that showed a positive balance until 1996, he misled Ashjian to rely on the fact that funds were available, even though respondent testified that the funds had been depleted by 1993. Further, respondent significantly harmed Ashjian in

that he has been deprived of funds to which he was entitled no later than 1993, the time of the final distribution. (Std.1.2(b)(iv).)

Respondent has demonstrated indifference toward rectification of or atonement for the consequences of his misconduct by refusing to resolve the matter and deliver the funds even after Ashjian obtained a municipal court judgment and a bankruptcy court finding of nondischargeability of the judgment. (Std.1.2(b)(v).) In addition, as the hearing judge aptly noted, respondent does not appear to exhibit any remorse or even recognition of his wrongdoing. (See *McKnight v. State Bar* (1991) 53 Cal.3d 1025, 1036-1037; *In re Rivas* (1989) 49 Cal.3d 794, 802.) Although respondent argues that he should not be criticized for his lack of remorse, since he is simply asserting his right to due process, we note that he failed to assert his right to request a trial de novo after the arbitration award or to file an appeal from the municipal court judgment. In view of respondent's failure to assert his rights at that time, we conclude that his argument in this respect is disingenuous and lacks credibility. Further, as to respondent's assertion that he lacks the ability to repay Ashjian, the record reflects that respondent had the ability to pay Ashjian for quite some time after Ashjian first obtained the municipal court judgment and during the bankruptcy court adversarial proceedings, since respondent through his attorney at that time offered to pay Ashjian $25,000 to settle the matter. And, in any event, respondent has not shown that he has made restitution/payment to Ashjian in accordance with his purported limited ability.

Level of Discipline

The hearing judge recommended disbarment pursuant to standard 2.2(a), which provides that willful misappropriation of entrusted funds shall result in disbarment subject to certain exceptions.

The primary purposes of the disciplinary proceedings are the protection of the public, the courts, and the legal profession; the maintenance of high professional standards by attorneys; and the preservation of public confidence in the legal profession. (Std. 1.3; *In re Morse, supra,* 11 Cal.4th at p. 205.) As previously stated, when an attorney assumes a fiduciary relationship and violates his duty in a manner that would justify disciplinary action if the relationship had been that of attorney and client, he may properly be disciplined for his misconduct. (*Clark v. State Bar, supra,* 39 Cal.2d at p. 166.)

In our search to recommend the proper discipline, we consider the standards, which serve as guidelines, as well as prior decisions imposing discipline based on similar facts. (*In re Morse, supra,* 11 Cal.4th at pp. 206-207; *In the Matter of Taylor* (Review Dept. 1991) 1 Cal. State Bar Ct. Rptr. 563, 580.) By far the most serious of respondent's offenses was his grossly negligent or intentional breach of fiduciary duty and misappropriation of over $20,000, which conduct involved moral turpitude. Standard 2.2(a) sets forth disbarment as the discipline to be imposed for willful misappropriation unless either the amount misappropriated is insignificantly small or the most compelling mitigating circumstances clearly predominate. That standard further provides that if disbarment is not imposed, the discipline shall include an actual suspension of at least one year, irrespective of mitigating circumstances. In this

case, the amount involved is not insignificantly small, nor do mitigating circumstances clearly predominate. Nevertheless, no fixed formula applies in determining the appropriate level of discipline. (*In the Matter of Brimberry* (Review Dept. 1995) 3 Cal. State Bar Ct. Rptr. 390, 403.) Instead, we determine the appropriate discipline in light of all relevant circumstances. (*Gary v. State Bar* (1988) 44 Cal.3d 820, 828.)

The Supreme Court has stated that misappropriation generally warrants disbarment in the absence of clearly mitigating circumstances. (*Kelly v. State Bar* (1988) 45 Cal.3d 649, 656; *Cain v. State Bar* (1979) 25 Cal.3d 956, 961.) Disbarment is most frequently imposed where there are several instances of misappropriation of large sums, involving multiple clients. (See *Rosenthal v. State Bar* (1987) 43 Cal.3d 658.) However, the Supreme Court has even imposed disbarment on an attorney with no prior record of discipline in a case of a single misappropriation even though there was substantial mitigation. (*In re Abbott* (1977) 19 Cal.3d 249 [misappropriation of $29,500 of client funds, display of remorse, showing of manic-depressive condition with uncertain prognosis].)

Disbarment has also been imposed where, although the misappropriation appears to be an isolated instance of misconduct, additional aggravating circumstances are present. In *Chang v. State Bar* (1989) 49 Cal.3d 114, Chang was found culpable in one client matter of misappropriating approximately $7,900 in client funds, failing to render an accounting to his client, and making misrepresentations to his client and to the State Bar. (*Id.* at pp. 123-124, 127-128.) As in the present case, in mitigation, Chang had no prior disciplinary record, yet he never acknowledged the impropriety of his conduct. (*Id.* at pp.

128-129.) In determining that Chang should be disbarred, the court focused upon his lack of candor to the State Bar's investigator and the State Bar Court, the seriousness of the misconduct, and the lack of either remorse or restitution. (*Ibid.*)

However, the Supreme Court has indicated in other misappropriation cases that discipline of less than disbarment is warranted where extenuating circumstances show that the misappropriation of entrusted funds is an isolated event and other mitigating circumstances are present. (See *Lawhorn v. State Bar* (1987) 43 Cal.3d 1357 [misappropriation of $1,355.75 of client funds resulting from negligence and inexperience, full restitution made with interest prior to State Bar investigation, two years' actual suspension].) In *Boehme v. State Bar* (1988) 47 Cal.3d 448, 451-452, 455, Boehme misappropriated $1,901.32 in client funds. In imposing a discipline of less than disbarment, the Supreme Court focused on Boehme's lack of prior discipline in over 20 years of practice, which the court found to be "an important mitigating circumstance" (*id.* at p. 454), and gave Boehme mitigating credit for a life-threatening medical emergency which occurred less than one month after the misappropriation occurred (*id.* at pp. 451, 454).

Respondent's breach of his fiduciary duties and misappropriation constitute serious misconduct. Moreover, as a result of such misconduct, respondent has harmed Ashjian by depriving him, for several years, of over $20,000, far from an insignificant sum. We are troubled by respondent's lack of recognition of wrongdoing, lack of remorse, and failure to make any restitution, particularly after Ashjian obtained a municipal court judgment with respect to the $20,946 and a bankruptcy court finding of

nondischargeability of the judgment. Finally, respondent's misappropriation and concealment of the misappropriation through the issuance of K-1 forms for several years "violated '"'the fundamental rule of [legal] ethics – that of common honesty – without which the profession is worse than valueless in the place it holds in the administration of justice'. . . . "' [Citation.]" (*In re Menna* (1995) 11 Cal.4th 975, 989.)

However, based on the cases cited above, we do not believe disbarment is needed in this case. First, this matter appears to have been an isolated instance of misconduct, as all of the misconduct found resulted from a single failure to distribute funds to Ashjian. Second, respondent has had no prior record of discipline in over 40 years of practice. Thus, although the record does not provide a justifiable explanation for the misconduct, the misconduct appears to be aberrational. In view of these two factors, combined with respondent's evidence of good character and community service, we decline to adopt the hearing judge's disbarment recommendation and instead conclude that a lengthy period of actual suspension will adequately serve the disciplinary goals of these proceedings.

RECOMMENDATION

We recommend that respondent Charles Connell McCarthy be suspended from the practice of law in the State of California for four years, that execution of the four-year suspension be stayed, and that respondent be placed on probation for three years on the following conditions:

1. Respondent shall be actually suspended from the practice of law in the State of California during the first two years of probation and until: (a) respondent pays restitution to Nazar H. Ashjian, or the Client Security Fund if it has paid, in the amount of $27,493.22, plus 10 percent simple interest per annum from December 19, 1995, until paid, and provides satisfactory proof of such payment to the State Bar's Probation Unit in Los Angeles; and (b) if respondent's actual suspension extends for more than two years, respondent shows proof satisfactory to the State Bar Court of respondent's rehabilitation, present fitness to practice, and present learning and ability in the general law, in accordance with standard 1.4(c)(ii) of the Standards for Attorney Sanctions for Professional Misconduct. We recommend that respondent be given credit for the period of his involuntary inactive enrollment under Business and Professions Code section 6007, subdivision (c)(4) towards this recommended two-year period of actual suspension.

2. Respondent shall comply with the provisions of the State Bar Act, the Rules of Professional Conduct of the State Bar of California, and all the terms and conditions of this probation.

3. Respondent shall report, in writing, to the State Bar's Probation Unit in Los Angeles no later than January 10, April 10, July 10 and October 10 of each year or part thereof in which respondent is on probation (reporting dates). However, if respondent's probation begins less than 30 days before a reporting date, respondent may submit the first report no later than the second reporting date after the beginning of his probation. In each report, respondent shall state that it covers the preceding calendar quarter or applicable portion and certify by affidavit or under penalty of perjury under the laws of the State of California as follows:

(a) in the first report, whether respondent has complied with all the provisions of the State Bar Act, the Rules of Professional Conduct of the State Bar, and all other terms and conditions of probation since the beginning of probation; and

(b) in each subsequent report, whether respondent has complied with all the provisions of the State Bar Act, the Rules of Professional Conduct of the State Bar, and all other terms and conditions of probation during that period.

During the last 20 days of this probation, respondent shall submit a final report covering any period of probation remaining after and not covered by the last quarterly report required under this probation condition. In this final report, respondent shall certify to the matters set forth in subparagraph (b) of this probation condition by affidavit or under penalty of perjury under the laws of the State of California.

4. Subject to the assertion of applicable privileges, respondent shall fully, promptly, and truthfully answer any inquiries of the State Bar's Probation Unit and any assigned probation monitor referee that are directed to respondent, whether orally or in writing, relating to whether respondent is complying or has complied with the terms and conditions of this probation.

5. During the period of respondent's actual suspension, respondent shall attend and satisfactorily complete the State Bar's Ethics School and provide satisfactory proof of such completion to the State Bar's Probation Unit in Los Angeles. This condition of probation is separate and apart from respondent's California Minimum Continuing Legal Education (MCLE) requirements; accordingly, respondent is ordered not to

claim any MCLE credit for attending and completing this course.

6. Respondent's probation shall commence on the effective date of the Supreme Court order imposing discipline in this matter. And, at the end of the probationary term, if respondent has complied with the terms and conditions of probation, the Supreme Court order suspending respondent from the practice of law for four years shall be satisfied, and the suspension shall be terminated.

Professional Responsibility Examination

We further recommend that respondent be ordered to take and pass the Multistate Professional Responsibility Examination administered by the National Conference of Bar Examiners within one year after the effective date of the Supreme Court order in this matter or during the period of respondent's actual suspension, whichever is greater, and to provide satisfactory proof of such passage to the State Bar's Probation Unit in Los Angeles during the same period.

Rule 955

We further recommend that respondent be ordered to comply with rule 955 of the California Rules of Court and to perform the acts specified in subdivisions (a) and (c) of that rule within 30 and 40 calendar days, respectively, after the effective date of the Supreme Court order in this matter.

Costs

We further recommend that the costs incurred by the State Bar in this matter be awarded to the State Bar in accordance with Business and Professions Code section 6086.10 and that such costs be payable in accordance with Business and Professions Code section 6140.7.

Order

Finally, because we reject the hearing judge's disbarment recommendation, we order that respondent's involuntary inactive enrollment under Business and Professions Code section 6007, subdivision (c)(4) be terminated, effective immediately. This order does not affect respondent's ineligibility to practice law that has resulted or may hereafter result from any other cause.

WATAI, J.

We concur:

STOVITZ, P.J.

OBRIEN, J.*

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* Judge Pro Tem of the State Bar Court, appointed by the State Bar Board of Governors under rule 14 of the Rules of Procedure of the State Bar.

Case No. 96-O-00528

In the Matter of Charles Connell McCarthy

Hearing Judge

Nancy Roberts Lonsdale

Counsel for the Parties

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APPENDIX C

REVIEW DEPARTMENT OF THE STATE BAR COURT

IN BANK

In the Matter of Charles Connell McCarthy, A Member of the State Bar.	96-O-00528 ORDER MODIFYING OPINION (Filed Apr. 25, 2002)

On our own motion, we modify our opinion on review filed April 15, 2002, as set forth below.

1. On page 2, last line, the word "pleads" is changed to "pleaded."

2. On page 22, line 3, the word "were" is changed to "was."

3. On page 29, line 10, the word "the" is added between the words "of" and "CitiSavings."

4. On page 37, line 10, the date "December 19, 1995" is changed to "November 8, 1995."

5. On page 38, line 8, the words "During the period of respondent's actual suspension" is changed to "Within one year after the effective date of the Supreme Court order in this matter."

6. On page 38, after the second full paragraph, the following paragraph is inserted:

> 6. In addition to maintaining an official address for State Bar purposes with the State Bar's Membership Records Office as

required by section 6002.1 of the Business and Professions Code, respondent shall maintain that official address with the State Bar's Probation Unit in Los Angeles. Within ten (10) days of any change, respondent shall report to the State Bar's Membership Records Office and to the Probation Unit all changes of information, including current office address and telephone number, or if no office serve the disciplinary goals of these proceedings.

RECOMMENDATION

We recommend that respondent Charles Connell McCarthy be suspended from the practice of law in the State of California for four years, that execution of the four-year suspension be stayed, and that respondent be placed on probation for three years on the following conditions:

1. Respondent shall be actually suspended from the practice of law in the State of California during the first two years of probation and until: (a) respondent pays restitution to Nazar H. Ashjian, or the Client Security Fund if it has paid, in the amount of $27,493.22, plus 10 percent simple interest per annum from December 19, 1995, until paid, and provides satisfactory proof of such payment to the State Bar's Probation Unit in Los Angeles; and (b) if respondent's actual suspension extends for more than two years, respondent shows proof satisfactory to the State Bar Court of respondent's rehabilitation, present fitness to practice, and present learning and ability in the general law, in accordance with standard 1.4(c)(ii) of the Standards for Attorney Sanctions for Professional Misconduct. We recommend that respondent be given

credit for the period of his involuntary inactive enrollment under Business and Professions Code section 6007, subdivision (c)(4) towards this recommended two-year period of actual suspension.

2. Respondent shall comply with the provisions of the State Bar Act, the Rules of Professional Conduct of the State Bar of California, and all the terms and conditions of this probation.

3. Respondent shall report, in writing, to the State Bar's Probation Unit in Los Angeles no later than January 10, April 10, July 10 and October 10 of each year or part thereof in which respondent is on probation (reporting dates). However, if respondent's probation begins less than 30 days before a reporting date, respondent may submit the first report no later than the second reporting date after the beginning of his probation. In each report, respondent shall state that it covers the preceding calendar quarter or applicable portion and certify by affidavit or under penalty of perjury under the laws of the State of California as follows:

   (a) in the first report, whether respondent has complied with all the provisions of the State Bar Act, the Rules of Professional Conduct of the State Bar, and all other terms and conditions of probation since the beginning of probation; and

   (b) in each subsequent report, whether respondent has complied with all the provisions of the State Bar Act, the Rules of Professional Conduct of the State Bar, and all other terms and conditions of probation during that period.

During the last 20 days of this probation, respondent shall submit a final report covering any period of probation remaining after and not covered by the last quarterly report required under this probation condition. In this final report, respondent shall certify to the matters set forth in subparagraph (b) of this probation condition by affidavit or under penalty of perjury under the laws of the State of California.

4. Subject to the assertion of applicable privileges, respondent shall fully, promptly, and truthfully answer any inquiries of the State Bar's Probation Unit and any assigned probation monitor referee that are directed to respondent, whether orally or in writing, relating to whether respondent is complying or has complied with the terms and conditions of this probation.

5. During this period of respondent's actual suspension, respondent shall attend and satisfactorily complete the State Bar's Ethics School and provide satisfactory proof of such completion to the State Bar's Probation Unit in Los Angeles. This condition of probation is separate and apart from respondent's California Minimum Continuing Legal Education (MCLE) requirements; accordingly, respondent is ordered not to claim any MCLE credit for attending and completing this course.

6. Respondent's probation shall commence on the effective date of the Supreme Court order imposing discipline in this matter. And, at the end of the probationary term, if respondent has complied with the terms and conditions of probation, the Supreme Court order suspending respondent from the practice of law for four years shall be satisfied, and the suspension shall be terminated.

Professional Responsibility Examination

We further recommend that respondent be ordered to take and pass the Multistate Professional Responsibility Examination administered by the National Conference of Bar Examiners within one year after the effective date of the Supreme Court order in this matter or during the period of respondent's actual suspension, whichever is greater, and to provide satisfactory proof of such passage to the State Bar's Probation Unit in Los Angeles during the same period.

Rule 955

We further recommend that respondent be ordered to comply with rule 955 of the California Rules of Court and to perform the acts specified in subdivisions (a) and (c) of that rule within 30 and 40 calendar days, respectively, after the effective date of the Supreme Court order in this matter.

Costs

We further recommend that the costs incurred by the State Bar in this matter be awarded to the State Bar in accordance with Business and Professions Code section 6086.10 and that such costs be payable in accordance with Business and Professions Code section 6140.7

Order

Finally, because we reject the hearing judge's disbarment recommendation, we order that respondent's involuntary inactive enrollment under Business and Professions Code section 6007, subdivision (c)(4) be terminated, effective

immediately. This order does not affect respondent's ineligibility to practice law that has resulted or may hereafter result from any other cause.

WATAI, J.

We concur:

STOVITZ, P.J.

OBRIEN, J.*

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* Judge Pro Tem of the State Bar Court, appointed by the State Bar Board of Governors under rule 14 of the Rules of Procedure of the State Bar.

APPENDIX D

THE STATE BAR COURT

HEARING DEPARTMENT – LOS ANGELES

In the Matter of CHARLES C. MCCARTHY #20803 Member of the State Bar	Case No. 96-O-00528 DECISION AND RECOMMENDATION (Filed Aug. 11, 2000)

DECISION

Introduction:

This is a contested original proceeding. Office of the Chief Trial Counsel (OCTC) was represented by deputy trial counsel Luis Casillas-Robles. Respondent Charles C. McCarthy (respondent) was represented by Henry Heuer, Esq. Trial was held on June 13, 14, 15, and July 19, 2000. The matter stood submitted following oral argument on July 19, 2000.

For the reasons hereafter stated, respondent is found culpable of the disciplinary charges alleged against him. It is recommended that he be disbarred.

Jurisdiction:

Respondent was admitted to the State Bar on June 14, 1949, and has been a member since that time.

Findings of Fact:

In 1967, respondent became the general partner in a limited partnership call Kua Kona Limited Partnership (Kua Kona LP). The purpose of the partnership was to purchase land on the big island of Hawaii. A parcel of approximately 1400 acres was purchased on the Kona

coast. Limited partners invested capital in varying amounts to make the down-payment on the property, and were required to make additional annual contributions to cover the mortgage payments. All of this money was tax deductible under the tax laws at that time, thus providing an immediate benefit to the limited partners, many of whom were very wealthy.

In 1971, the State of Hawaii condemned 400 acres of the Kua Kona LP property in order to build an airport. The money realized from this sale was sufficient to pay off the mortgage on the rest of the property. The limited partnership then owned 1000 acres free and clear, and limited partners were not required to make any further capital contributions. In fact, much of the capital they had contributed to the enterprise was returned to them.

Respondent attempted to develop or sell the property for many years, without success. In 1986, he placed the Kua Kona LP in bankruptcy. In 1988, he found a buyer for the property, for the sum of 5.25 million dollars. With the approval of the bankruptcy court, respondent paid all partnership debts and proposed a distribution of most of the remaining profit. Pursuant to the terms of the limited partnership agreement, he first returned all remaining capital contributions, then made a distribution of ninety percent of the remaining funds. (Ten percent was kept as a reserve against contingencies.) Each partner's distribution was calculated according to its investment percentage.

Respondent prepared and sent a letter, on July 27, 1988, advising each limited partner of this transaction, and of the amount it would be receiving under the distribution. Together with this letter, respondent enclosed a

release which absolved him personally, as general partner, from any claims relating to the Kua Kona LP.

Most of the partners signed and returned the release and were promptly paid. One, the estate of a large investor, did not want to sign the release. After litigation, a settlement was reached, and the estate representative signed a slightly modified release. It was paid its share of the distribution.

Another investor, with a small percentage investment, named Nazar Ashjian, also did not want to sign the release as written. He sent back a modified "mutual release," which respondent refused to accept. Mr. Ashjian then consulted counsel, who advised him to sign the release and litigate the matter of mutuality later if it became necessary. Mr. Ashjian then signed the unmodified release. His attorney sent it to respondent, with a cover letter, on August 18, 1988. That cover letter stated Mr. Ashjian's position that the release was mutual.

Respondent still refused to release Mr. Ashjian's distribution, which was in the amount of $20,946. He did not segregate the money from other partnership funds, which he retained in a bank account; nor did he place it in a trust account. He nevertheless had sufficient monies on hand to pay Mr. Ashjian until at least 1993.

In the early nineties, respondent involved the Kua Kona LP in a lawsuit against a savings and loan. He and other parties were co-plaintiffs. He spent approximately one million dollars in attorneys fees on this litigation, including his own personal funds, money from co-plaintiffs, and all remaining monies of the Kua Kona LP, which included Mr. Ashjian's distribution. This law suit was only marginally successful, as the Federal Resolution

Trust took over the savings and loan, and the lawsuit against it was therefore dismissed. The savings and loan's attorneys, co-defendants, settled the suit with respondent for one million dollars. Respondent paid debts and then distributed a share of this money to the limited partners, including Mr. Ashjian, without a release.

Until 1995, respondent had sent Mr. Ashjian a K-1 each year which showed that he still had $22,258 in his capital account with Kua Kona LP. Mr. Ashjian, an accountant, understood this money to represent his unreturned capital contributions and distribution share, plus the ten percent which respondent had retained for contingencies. Respondent disagreed with this analysis, but was never able to explain clearly what the figure on the K-1 represented.

In 1996, Mr. Ashjian received a K-1 from respondent which showed a zero balance in his capital account. At this point he realized that respondent had spent the money he was owed. He sued respondent in municipal court. The matter was arbitrated and an award against respondent in the amount of $31,606.22 ($20,946 in principal and $10,660.22 in interest) was made. The arbitrator specifically found that respondent had breached his fiduciary duty to Mr. Ashjian by not paying him his distribution. This award was later reduced to a judgment.

Mr. Ashjian was able to levy one bank account of respondent's for approximately $4000. Respondent then filed bankruptcy, which stopped further collection efforts. Mr. Ashjian filed an adversary action in the bankruptcy, and was successful in having the debt reaffirmed, due to respondent's defalcation of his funds. However, Mr. Ashjian has never been paid.

In the course of the bankruptcy proceedings, respondent's attorney and Mr. Ashjian reached a tentative settlement of the dispute. A condition of this settlement was that Mr. Ashjian would withdraw the complaint against respondent which he had filed with the State Bar. Respondent was aware of the letter which set forth this condition, and did nothing to disavow it. He claimed at trial that the condition was Mr. Ashjian's idea. Mr. Ashjian denied this and respondent's attorney was not called as a witness. The settlement was never completed.

It was clear from his demeanor, and statements made at trial and in various pretrial papers, that respondent harbored a great deal of personal animosity toward Mr. Ashjian.

Conclusions:

Count One:

When the distribution was made to all limited partners, Mr. Ashjian's share became his property, rather than the partnership's property. As a fiduciary (and a California attorney), respondent was obligated to keep Mr. Ashjian's distribution share in trust until the dispute over the distribution was resolved. Instead, he dishonestly or with gross negligence failed to keep Mr. Ashjian's money in trust. He allegedly instead spent it for other partnership purposes, i. e., attorneys fees for litigation in which he involved the limited partnership. His misappropriation constitutes an act of moral turpitude in violation of section 6106 of the Business and Professions Code.

Respondent has raised a number of arguments as to why his use of Mr. Ashjian's money for other limited partnership purposes was not a misappropriation. First,

he claims that because Mr. Ashjian never signed the release he requested, he was entitled to keep his distribution. This argument fails for at least two reasons. In the court's view (which was also the view of the arbitrator in the municipal court action) respondent had no right to insist upon a release. As general partner, he was a fiduciary to the limited partners, and it was a breach of that fiduciary relationship for respondent to insist upon a release of all claims against him personally as a condition of the distribution.

Respondent argues that because the court in the probate estate matter allowed the estate's representative to sign a modified version of the release, that establishes that the release was proper. This argument simply misstates the evidence. Respondent and the estate reached a settlement pursuant to which the estate representative signed a slightly modified release. There was no litigation establishing the propriety of respondent's insistence on the release.

Secondly, Mr. Ashjian did execute the release which respondent requested, within three weeks of receiving it. The fact that Mr. Ashjian purported to place a condition of mutuality on the release was irrelevant. Respondent had the signed release he wanted form Mr. Ashjian. It precluded Mr. Ashjian from suing respondent. The "mutuality" issue could have been litigated later had respondent, for some reason, attempted to sue Mr. Ashjian.

Respondent also claims that there was no misappropriation because he did not personally use Mr. Ashjian's money to, for example, go to Las Vegas. Again, this argument must fail. Entrusted money need not be stolen for personal purposes to constitute a misappropriation. The

fact that the actual balance of the bank account in which entrusted funds are placed drops below the amount to which the beneficiary is entitled is sufficient to support a finding of wilful misappropriation. (*Edwards v. State Bar* (1990) 52 Cal. 3d 28, 37; *Palomo v. State Bar* (1984) 36 Cal. 3d 785, 795; *Chefsky v. State Bar* (1984) 36 Cal. 3d 116, 123.) If the balance in an attorney's trust account drops below the balance credited to the beneficiary as a result of the attorney's gross carelessness and negligence, the misappropriation is deemed wilful even in the absence of any evil intent, deliberate wrongdoing or dishonesty. (Ibid.) Such a misappropriation involves moral turpitude per se, in violation of section 6106 of the Business and Professions Code, because it results from the attorney's gross carelessness and negligence with respect to his fiduciary duty to properly handle and account for entrusted funds. (*Lipson v. State Bar* (1991) 53 Cal. 3d 1010, 1020-21; *Jackson v. State Bar* (1979) 23 Cal. 3d 509, 513.)

Further, respondent's use of Mr. Ashjian's funds did benefit respondent personally. As the general partner of Kua Kona LP, and a co-plaintiff in the lawsuit against the savings and loan, respondent was personally liable for the massive attorney's fees which he authorized. Monies paid from Mr. Ashjian's distribution were monies respondent did not have to pay personally. The fact that this was a business debt rather than a personal debt is irrelevant. (Further, it is less than clear why Mr. Ashjian's funds could not have been restored from the settlement of the lawsuit. Respondent had no trouble restoring to himself funds which he had advanced to the limited partnerships during the course of the litigation.)

Respondent testified that he had no fiduciary duty to Mr. Ashjian, and no obligation to segregate his distribution or keep it in trust. Respondent's understanding of the law governing fiduciaries, and California attorneys, is seriously mistaken. Further, it is clear that his personal dislike of Mr. Ashjian caused respondent to disregard his fiduciary duties toward him.

Count Two:

Count Two alleges that respondent's attorney sent a letter to Mr. Ashjian offering to settle the dispute over the distribution if, among other conditions, Mr. Ashjian would withdraw his complaint to the State Bar. Such a request constitutes a violation of section 6090.5(a)(2) of the Business and Professions Code.

Although respondent claims that he was not the one who wanted the State Bar complaint withdrawn, the Court is unable to accept his claim as credible. In a declaration he filed in the same bankruptcy action in which the settlement offer was made, respondent argues that Mr. Ashjian filed the State Bar complaint to gain advantage in his civil litigation. Clearly, respondent wanted the State Bar complaint withdrawn as part of any settlement. His attorney acted as his agent. If he did not instruct his attorney to condition the settlement upon this withdrawal, he certainly ratified his attorney's position by relying upon it and/or failing to repudiate it at any time. Respondent's alleged ignorance of his legal obligations as an attorney are no defense. There is clear and convincing evidence of a violation of section 6090.5(a)(2).

Level of Discipline:

OCTC requests that respondent be disbarred. Respondent argues that only a private reproval is appropriate.

Standard 2.2(a) of the Standard for Attorney Sanctions for Professional Misconduct (Standards) provides that wilful misappropriation of entrusted funds shall result in disbarment, unless the amount involved is insignificantly small, or the most compelling mitigating circumstances predominate. The sum involved here is not insignificantly small. Therefore, the analysis shifts to an examination of mitigating and aggravating factors.

In mitigation, respondent argues that he acted in good faith and in the best interests of the limited partnership as a whole. It is certainly true that respondent is not charged with any dishonesty or other misconduct in the handling of the limited partnership's affairs, other than the failure to distribute to Mr. Ashjian. Yet it is expressly rejected that respondent acted in good faith toward Mr. Ashjian. Respondent's personal animosity toward Mr. Ashjian led at least in part to his stubborn refusal to distribute Mr. Ashjian's funds.

Respondent also points out that he has been an attorney for fifty years, with no other complaints or record of discipline. Although respondent has not practiced law for approximately twenty years, and went on inactive status from 1991 to 1999, he does have a long and unblemished career prior to the commencement of his misconduct in 1988. This is a strong mitigating factor. However, a lengthy unblemished record is not sufficient in itself to preclude disbarment. (*Kaplan v. State Bar* (1991) 52 Cal. 3d 1067, 1071-72; *In the Matter of Spaith* (Review Dept. 1996) 3 Cal. State Bar Ct. Rptr. 511, 520; *In the Matter of Brazil* (Review Dept. 1994) 2 Cal. State Bar Ct. Rptr. 679,

688; *In the Matter of Kueker* (Review Dept. 1991) 1 Cal. State Bar Ct. Rptr. 583, 594.)

Respondent had two friends and associates, and his wife, testify to his honesty and good moral character. While this established some mitigation, it does not rise to the level of "an extraordinary demonstration of good character of the member attested to by a wide range of references in the legal and general communities" required by Standard 1.2(e)(vi). (*In the Matter of Myrdall* (Review Dept. 1995) 3 Cal. State Bar Ct. Rptr. 363, 387; *In the Matter of Heiner* (Review Dept. 1993) 2 Cal. State Bar Ct. Rptr. 559, 566; *In the Matter of Kueker, supra*, 1 Cal. State Bar Ct. Rptr. at 595.)

Respondent and his wife both testified to respondent's good works in the community, in bar associations, in his church and in civic affairs. Such activity is another indication of good character and is entitled to weight. (*Rose v. State Bar* (1989) 49 Cal. 3d 646, 665; *Allen v. State Bar* (1962) 58 Cal. 2d 912, 914; *In re Werner* (1954) 42 Cal. 2d 187, 190; *In the Matter of Crane and DePew* (Review Dept. 1990) 1 Cal. State Bar Ct. Rptr. 139, 158; *In the Matter of Respondent E* (Review Dept. 1991) 1 Cal. State Bar Ct. Rptr. 716, 729.)

There is no showing of lack of harm to the victim, of spontaneous candor and cooperation, or of objective steps promptly taken which demonstrate remorse and recognition of wrongdoing. There has, most significantly, been no attempt whatsoever at restitution.

In aggravation, respondent's conduct was in part surrounded by deceit. He continued to have a K-1 sent to Mr. Ashjian until 1995 which appeared to show that he still had Mr. Ashjian's money, even though he had spent it

all by, at the latest, 1993. This misled Mr. Ashjian about the availability of a source of repayment of his funds.[1]

Respondent's misconduct significantly harmed Mr. Ashjian, by depriving him of his rightful funds for almost twelve years.

Respondent has displayed not just indifference toward rectification of or atonement for the consequences of his misconduct. He affirmatively asserts that he has done nothing whatsoever wrong. He cannot seem to comprehend how anyone would view his actions toward Mr. Ashjian as improper, despite having been told by both the municipal court arbitrator and the bankruptcy court that his actions were wrongful.

Discussion:

OCTC argues most persuasively that only disbarment is an adequate remedy in this situation. The Court had hoped that, given respondent's lengthy unblemished record of service, some demonstration of remorse by respondent would lead it to a different conclusion, such as an actual suspension lasting until respondent provided restitution to Mr. Ashjian. Unfortunately the opposite has been the case. Respondent's request for a private reproval shows no understanding whatsoever of the seriousness of respondent's misconduct. He states that he cannot make restitution. He remains absolutely convinced that his actions were wholly proper. Respondent is entitled to his

[1] In an earlier ruling concerning a statute of limitations defense asserted by respondent, this Court ruled that Mr. Ashjian was misled until sometime in 1996 about whether respondent still had his monies.

belief, but there is no public protection where an attorney believes it is appropriate to breach his fiduciary duty in the handling of large sums of money.

This case is not distinguishable from other situations in which disbarment has been imposed. In *Kaplan v. State Bar*, *supra*, 52 Cal. 3d 1067, the attorney misappropriated many thousands of dollars from his law partners. Despite many years in practice, and attestations to his good character and the aberrational nature of his conduct, disbarment was imposed. In *In the Matter of Spaith, supra*, 3 Cal. State Bar Ct. Rptr. 511, the attorney misappropriated client monies. Again, a strong showing of mitigation did not preclude disbarment. In *In the Matter of Brazil, supra*, 2 Cal. State Bar Ct. Rptr. 679, the attorney misapplied a loan to a mortgage banking company by using the money to reduce debt rather than fund specific transactions. He also forged documents. He was convicted of forgery and grand theft. Despite extensive evidence of mitigation, the Review Department rejected the hearing department's recommendation of a lengthy suspension, and instead recommended disbarment.

Respondent's disbarment is necessary to protect the public, the courts, and the legal community, to preserve public confidence in the legal profession, and to maintain the highest possible standards of conduct for attorneys.

RECOMMEND DISCIPLINE

Based on the foregoing, it is recommended that Charles C. McCarthy be disbarred from the practice of law in California, and his name be stricken from the roll of attorneys.

It is further recommended that the Supreme Court order respondent to comply with the provisions of subdivisions (a) and (c) of rule 955, California Rules of Court, within 30 and 40 days, respectively, of the effective date of its order imposing discipline in this matter.

COSTS

It is further recommended that costs be awarded to the State Bar pursuant to Business and Professions Code section 6086.10, to be paid in accordance with section 6140.7 of that Code.

ORDER ENROLLING INACTIVE

Pursuant to section 6007(c)(4) of the Business and Professions Code, respondent Charles C. McCarthy is hereby involuntarily enrolled as an inactive member of the State Bar of California. This order is effective three days after service of this decision, recommendation, and order.

Dated: August 8, 2000

/s/ Nancy Roberts Lonsdale
Nancy Roberts Lonsdale
Judge of the State Bar Court

APPENDIX E

96-O-00528

IN THE

Supreme Court of California

In the Matter of CHARLES CONNELL McCARTHY, No. 20803 A Member of the State Bar	) Case No.: 96-O-00528)))))

After a Decision by the

Review Department of the State Bar Court

VERIFIED PETITION FOR WRIT OF REVIEW

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* * *

[1] TO THE HONORABLE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF CALIFORNIA:

Pursuant to California Rules of Court, Rule 952(a), Petitioner, CHARLES CONNELL McCARTHY ("Petitioner" or "McCarthy"), respectfully petitions this honorable Court for a Writ of Review following the Opinion on Review and Order Terminating Inactive Enrollment of the [2] Review Department of the State Bar Court dated April 15, 2002 and filed with this Court on August 15, 2002 recommending his suspension from the practice of law. A copy of the Review Department's April 15, 2002 Opinion on

Review and Order Terminating Inactive Enrollment, together with the Order Modifying Opinion dated April 25, 2002, are attached hereto as Appendix 1. Pursuant to California Rules of Court, Rules 952(e) and 954(a), this verified Petition follows exhaustion of all avenues of review in the State Bar Court.

ISSUES PRESENTED

1. The State Bar Court Review Department's opinion presents a question of law that is vitally important to every lawyer admitted to the State Bar of California: May the State Bar identify the purported factual basis for a "moral turpitude" disciplinary charge (or any other disciplinary charge) for the first time on appeal, after: having not alleged such purported conduct in the Notice of Disciplinary Charges ("NDC"), having not disclosed such purported conduct at any time in discovery, and having not litigated such purported conduct at the time of trial? By relying on a factual predicate that was not previously alleged (or disclosed in discovery or litigated at trial), the Review Department's opinion also raises the questions of whether Petitioner received a fair hearing and whether the Review Department's Opinion is supported by the weight of the evidence.

2. This Petition also presents the important question of whether the five year "Period of Limitations" set forth in Rule 51 of the State Bar Rules of Procedure is unconstitutional, either on its face or as applied to Petitioner in this case, with the State Bar Court permitting disciplinary [3] charges involving events occurring in 1988 to be brought to a hearing some 13 years later in 2001 and sustained on appeal in 2002.

3. Finally, this petition presents two important questions: 1) whether a party may "ratify" an agreement reached solely through his counsel without ever having "full knowledge of the material facts" vis a vis a charge of violating Business & Professions Code Section 6090.5(a)(2) and 2) whether the Review Department's conclusion that McCarthy had "ratified" such an agreement is supported by the weight of the evidence.

GROUNDS FOR REVIEW

Pursuant to Rule 954(a) of the California Rules of Court, this Court should grant review on the grounds that (1) review is necessary to settle important questions of law; (2) the State Bar Court has acted without or in excess of jurisdiction; (3) petitioner did not receive a fair hearing; and (4) the decision is not supported by the weight of the evidence.

Moreover, the United States Court of Appeal for the Ninth Circuit recently decided the case of *Canatella v. California*, 2002 U.S. App. LEXIS 18468, which has been remanded to the trial court for a determination whether, *inter alia*, California Business & Professions Code Section 6106 is unconstitutional on its face for vagueness and overbreadth in violation of the First and Fourteenth Amendments of the United States Constitution. A final determination in *Canatella* that Section 6106 is unconstitutional under federal law could render moot Petitioner's challenges to the moral turpitude charge brought against him.

[4] **PETITION**

Petitioner alleges:

1. McCarthy is 80 years old, was admitted to the State Bar of California on June 14, 1949, over 50 years ago, and was active until December 31, 1991 and again from July 6, 1999 through the time of trial of this case. Before this proceeding, no recommendation for discipline for professional or other misconduct had ever been made by the Board of Governors or a Disciplinary Board to this Court. (Ex. 1.)

2. On or about October 10, 1967, McCarthy formed a California limited partnership named Kau-Kona Land Company ("Kau") (Ex. 2, pp.2-3) for the purpose of making a tax shelter purchase of 1,400 acres of unimproved land near Kona, Hawaii, for $1.4 million – two years of prepaid interest only to close. The 23 original Kau limited partners made a total initial capital contribution of $300,000.00. The complaining witness in this case, Nazar H. Ashjian, Jr. ("Ashjian"), a certified public accountant (RT, I-33:10), made an initial capital contribution of $300.00 held a 0.6% interest in profits and losses. (McCarthy Decl. of November 3, 1999 ("McCarthy Decl.") 2:14-7:4; Ex. 2, pp. 1-2.)

3. The Kau Agreement specifically provided that:

> ***General Partners*** shall have the ***exclusive right to determine whether and when to make distributions to the Partners***. . . . (Ex. 2, Art. V. ¶ D, p. 7) (emphasis added)
>
> The ***Limited Partners shall take no part in, or interfere in any manner with, the conduct or control of the partnership business***. . . . (Ex. 2, Art. XI, p. 15) (emphasis added)

4. Under McCarthy's stewardship, Kau improved the value of its land by, among other things, introducing water and successfully petitioning [5] for favorable zoning. (Exs. I, L, M.) In 1983, the upper 732 acres was appraised at $13.4 million. (McCarthy Decl. 8:7-9.)

5. In approximately 1987, after holding the property for 20 years, McCarthy was able to obtain financing to develop Kau's Hawaii real estate. (RT, II-21:25-22:4; Ex. M, p. 1.) However, the lender, Citisavings of San Antonio, Texas, eventually reneged on its loan commitment (RT, II-22:8-10), and Kau was forced to sell the property in its undeveloped state.

6. In 1988, the Kau property was sold for $5,250,000.00 cash under the supervision of the Hawaii Bankruptcy Court. (Ex. 4, p. 1.) By letter dated July 27, 1988, McCarthy informed all the limited partners, including Ashjian, that there would be a preliminary distribution but, in light of Kau's contingent liabilities, requested that each of the limited partners first execute a document releasing Kau and McCarthy (as general partner) of any liability. (Ex. 4, pp. 1-5.) Alternatively, the limited partners were asked to inform McCarthy of any claims against him or Kau. (Ex. 4, p. 5.) None of the partners, including Ashjian, ever informed McCarthy of any such claim. (RT, II-24:3-9.) Ashjian, "refused to sign the release" (NDC, 3:1) and thus no preliminary distribution was made to him.

7. Prior to requesting the Kau limited partners to sign such a release, McCarthy obtained legal advice as to the propriety of such a document from Kau's attorney, William Bullis ("Bullis"); however, the Hearing Department refused to allow Bullis to testify on this subject. (RT, III-33:15-22; 34:10-18; 35:11-36:12.) McCarthy also

conferred with Robert Schiller ("Schiller"), whose financial management company represented approximately 40% of the Kau ownership interest. (RT, II-83:2-6.) Based on his experience in "several land deals" and limited partnerships [6] over some 25 years, Schiller recommended that the release would be "proper," a "good idea," and offered "protection for the partnership." (RT, II-84:10-85:2; 91:12-92:1.) After McCarthy distributed the letter and release, Schiller recommended that his clients sign it. (RT, II-85:3-7.) All of Schiller's clients and indeed, all but three limited partners, including Ashjian, signed the release and received their preliminary distributions. (RT, II-28:1-3; II-41:15-42:14; II-44:13-15.)

8. The Estate of Elinor Mayer Bryden was a successor limited partner with a 10% share of Kau profits. (Ex. 2, Ex. B thereto.) Like Ashjian, the Bryden Estate also initially refused to sign the release and commenced litigation challenging its propriety. (Ex. III, 3:3-7; Ex. D thereto.) The litigation concluded on July 11, 1989 with Judge Richard Hubbell of the Los Angeles Superior Court ordering Bryden's executor to "sign and give to Kau Kona Land Co. the Warranty, Indemnification and Release Re Preliminary Distribution of Profits presented by Kau Kona Land Co. for signature by is limited partners. . . . (Ex. SSS (Ex. 29 to McCarthy Decl.), 1:24-2:5.) Bryden's executor did so, and the estate received its preliminary distribution.

9. In September 1989, Kau and other co-plaintiffs (including McCarthy individually) filed a lawsuit in Hawaii alleging breach of the covenant of good faith and fair dealing against Citisavings and their attorneys. (RT, II-29:18-30:20; McCarthy Decl. p. 13; Ex. 31 to McCarthy Decl, 13:14-19.) Inclusive of punitive damages, the prayer sought $41,000,000.00 in damages. (RT, II-32:23-33:3.) Six

weeks into trial, in [7] the fall of 1990, "things were going very very well"[1] until the Resolution Trust Corporation took over Citisavings and necessitated dismissal. (RT, II-34:20-24.) The lawsuit against the attorneys continued, however, and was eventually settled in 1992 for $1 million. (RT, II-34:24-35:1; Ex. 14.)

10. The costs, including attorney's fees, of the *Citisavings* litigation were "at least a million dollars and more" as of the dismissal of Citisavings in September 1990.[2] (RT, II-151:7; 154:4-155:3.) The lawsuit against the attorneys continued, as did the costs. (RT, II-154:4-155:3.) All Kau's remaining cash was used to pay these "very, very substantial costs of litigation" beginning in 1989 and was exhausted "early on" by 1993.[3] (RT, II-31:25-32:4; II-39:24-40:11.) After Kau and the other co-plaintiff were unable to pay their shares of the litigation expenses (RT, II-32:9-10), McCarthy not only paid his own share but personally made up these shortfalls and in total advanced approximately $500,000.00 to pay for this litigation. (RT, II-32:11-16.)

11. After the lawsuit against the attorneys was settled, McCarthy distributed Kau's share of the proceeds to the limited partners. Ashjian acknowledged receiving

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[1] "A polling of the jurors following dismissal revealed that they favored awarding us a multi-million dollar verdict." (Ex. 14.)

[2] McCarthy made the documents supporting these costs available to the OCTC, which declined to review them. (RT, II-155:6-8; II-154:6-8.)

[3] McCarthy never used even one penny of Kau funds for his personal use. (RT, II-36:12-15.) This testimony was uncontradicted.

his share (RT, I-69:11-14), along with a letter from Attorney Bullis dated May 11, 1993 to Attorney Fred Stern (Ashjian's counsel), which stated in relevant part: "With the settlement of this lawsuit, [8] all of the business and affairs of the Kau Partnership have been completed." (Ex. 15, p. 2; RT, I-71:11-72:5; I-107:9-19.)

12. After he refused to sign the release (RT, I-53:2-7; NDC 3:1-2), Ashjian promptly retained counsel at a major law firm in August 1988 to represent him against McCarthy. (Decision, 3:12-13; Ex. BBBB.) Had Ashjian simply signed the release, he would have received his distribution. (RT, II-128:9-11.) Instead, Ashjian testified that he had insisted on three additional and "material" conditions (including a provision that the release be mutual) that were not requested by or granted to any of the other Kau limited partners. (RT, I-53:15-22; I-103:23-104:5; I-53:19-21.)

13. Despite the July 11, 1989 *Bryden* order, Ashjian nonetheless brought suit against Kau and McCarthy in Los Angeles Municipal Court (*Ashjian v. McCarthy*, Case No. 94E04139), alleging only breach of contract and several common counts. (RT, I-65:18-20; Ex. 16.) The case was referred to a volunteer arbitrator, who ignored the broad discretion granted to McCarthy as general partner by the Kau partnership agreement and the *Bryden* approval of the identical warranty and release by entering an award in favor of Ashjian for breach of fiduciary duty – which was not even pleaded. (see Ex. 16, pp. 100-105.) In light of his anticipated discharge via bankruptcy and his lack of financial resources, McCarthy did not appeal.

14. On May 21, 1996, McCarthy filed a voluntary petition under Chapter 7 of the United States Bankruptcy

Code. (RT, III-18:5-6; Ex. VV, 1:24-26.) Pursuant to the partnership agreement, Kau was dissolved. (RT, II-111:16-112:1; Ex. 2, p. 17.) On August 22, 1996, Ashjian filed an adversary complaint to determine whether the Municipal Court judgment was nondischargeable. (Ex. VV, 1:26-2:1.) On July 29, 1997, partial [9] summary judgment was entered in favor of Ashjian. (Ex. WW, 1:22-27.) Judge Arthur Greenwald bestowed preclusive effect on the arbitration award, even though: 1) there was a previous court order (in *Bryden*) approving the very same warranty and release; 2) McCarthy had explicitly been granted broad discretion in overseeing the partnership; 3) breach of fiduciary duty had not even been alleged in the Municipal Court case; and 4) perhaps most significantly, under California law, collateral estoppel does not apply where the prior "judgment" is merely a judicial arbitration proceeding (*Flynn v. Gorton* (1989) 207 Cal.App.3d 1550, 1555-56). (Ex. VV, 4:18-24.)

15. Ashjian inexplicably delayed for nearly five years in reducing his partial summary judgment order to a judgment, which was not entered until February 6, 2002 (a copy of which is attached hereto as Appendix 2). McCarthy appealed to the United States District Court, which summarily affirmed the judgment. McCarthy has not yet appealed the case to the Ninth Circuit (a Notice of Appeal is due to be filed on or before October 25, 2002) though he intends to do so.

16. During the pendency of the adversary complaint, Ashjian and McCarthy's attorney, James R. Felton, Esq. ("Felton"), McCarthy's counsel engaged in settlement discussions. At the time of such settlement discussions, *i.e.*, March 1997, McCarthy had not been an active member of the bar for approximately six years (Ex. 1), had not

actively practiced in approximately 17 years (RT, I-154:24-155:1), and was thus represented by legal counsel upon whom he relied exclusively in good faith. (RT, I-144:7-9.) Ashjian acknowledged that he only communicated with Felton and [10] never discussed the matter directly with McCarthy.[4] (RT, I-118:2-7.)

17. On March 7, 1997, Felton sent a letter to Ashjian confirming the terms of a proposed settlement, and also set forth additional understandings. (Ex. 20.) As McCarthy understood it, Ashjian agreed to dismiss his adversary claim in exchange for the payment of $25,000.00. (RT, I-148:5-11.) Separate and apart from the terms of the settlement, Ashjian had volunteered to dismiss his State Bar complaint (RT, I-149:11-13) in keeping with his stated desire of "you give me my money and I'll go my way and I won't bother you and you won't bother me." (RT, I-53:20-21.) McCarthy had "no control" over Ashjian's decision whether to proceed with his State Bar complaint. (RT, I-148:9-11.) Dismissal of the State Bar complaint was not a condition to the proposed settlement. (RT, I-150:8-19; I-151:11-14; I-153:11-18.) At that point, McCarthy had had no discussions with Felton regarding the possibility of the withdrawal of the State Bar complaint, and at no time did McCarthy instruct Felton to negotiate such a term into any settlement. (RT, I-154:3-6; I-154:18-20.) McCarthy never saw Exhibit 20 until receiving a copy in the mail and had no idea that Felton was even discussing withdrawal of the State Bar complaint with Ashjian. (RT,

[4] Indeed, Ashjian described the failed agreement as "what I thought was an agreement between myself and Mr. Felton." (RT, I-111:9-10.)

I-154:7-17.) McCarthy was unaware that including such a withdrawal was improper under Business and Professions Code Section 6090.5, nor was he so informed by Felton. (RT, I-152:8-9.)

18. The Review Department noted that the failure of the settlement with Ashjian was "particularly inexplicable." (Rev. Dept. Opin. p. 10, n.10.) The reason for the failed settlement is simple: at the last [11] moment, Ashjian demanded an additional $10,000.00, for a total of $35,000.00 (a copy of Ashjian's March 21, 1997 letter and proposed settlement agreement is attached hereto as "Appendix 3.")

19. Although the NDC alleges wrongdoing as early as 1988, and Ashjian filed a complaint with the State Bar on January 23, 1996, the NDC was not filed until November 24, 1999 and purports to allege two counts: 1) violation of Business and Professions Code Section 6106 (moral turpitude) and 2) violation of Business and Professions Code Section 6090.5(a)(2) (seeking an agreement to withdraw a State Bar complaint).

20. McCarthy's response asserted several affirmative defenses including *inter alia*: Expiration of the Period of Limitations; Laches; Failure to State Disciplinary Charges Adequately; Business Judgment Rule; Good Faith Reliance on a Valid Court Order; Good Faith Reliance on Counsel; and Complainant's Unclean Hands.

21. On May 30, 2000, McCarthy made a Motion to Dismiss pursuant to Rule 262(c) of the State Bar Rules of Procedure. On June 6, 2000, the OCTC opposed. Without allowing McCarthy the opportunity to reply or present oral argument, on June 7, 2000, the Hearing Department

issued a 1½ page order denying McCarthy's Motion to Dismiss.

22. Trial commenced on June 13, 2000. Richard Hyde, Kau's longtime certified public accountant, was by then retired and unable to testify in person due to his elderly wife undergoing major surgery. The Hearing Department refused to permit Hyde to testify via telephone, a crucial exclusion in light of the State Bar's subsequent rationale for denying McCarthy's defense of the expiration of the period of limitations: that McCarthy had concealed his purported misappropriation by manipulating [12] Ashjian's K1 form. (Hearing Dept. Opin. 4:11-12; Rev. Dept. Opin. p. 22, n. 16) Hyde would have testified that there was no such concealment.

23. At the close of the OCTC's case in chief, McCarthy made a motion for a determination that the OCTC failed to meet its burden of proof as to both Count One and Count Two pursuant to Rule 219 of the State Bar Rules of Procedure. The Hearing Department denied the motion.

24. The Hearing Department issued its Culpability Ruling on June 30, 2000 and its Decision and Recommendation on August 11, 2000.

25. McCarthy appealed. The case was briefed, and the Review Department considered oral argument on January 17, 2002. On April 15, 2002, the Review Department issued its Opinion.

26. It is respectfully submitted that Rule 101(b)(1)(2) and (3) of the Rules of Procedure of the State Bar of California and this Court's holding in *Baker v. State Bar* (1990) 49 Cal.3d 804, 816 – in addition to basic fairness

and McCarthy's Constitutional right to due process – require that the State Bar must: 1) identify the purported factual basis for a "moral turpitude" disciplinary charge (or any other disciplinary charge) in the NDC; 2) must disclose such facts, if any, in discovery; and 3) must actually present evidence of such facts, if any, at the time of trial. To the extent that such purported factual basis is identified for the first time on appeal, it is respectfully submitted that the State Bar deprives a respondent such as McCarthy of his constitutional right to due process and a fair hearing. Indeed, to the extent that the State Bar purports to find a respondent such as McCarthy culpable, it acts without jurisdiction.

27. It is further respectfully submitted that the "Period of Limitations" set forth in Rule 51 of the State Bar Rules of Procedures is [13] unconstitutional, on its face and/or as applied to McCarthy, with the State Bar Court permitting disciplinary, charges involving events alleged to have occurred in 1988 to be litigated pursuant to the NDC filed in 1999.

28. It is further respectfully submitted that without "full knowledge of the material facts" (in this case, the failure of counsel to advise that agreeing or seeking an agreement to withdraw a State Bar complaint is a violation of Section 6090.5(a)(2)), a party such as McCarthy cannot "ratify" an agreement reached solely through his counsel.

WHEREFORE, Petitioner, CHARLES CONNELL McCARTHY, respectfully requests that this Court grant this Petition for Writ of Review to: 1) determine the propriety of identifying the purported factual basis for a "moral turpitude" disciplinary charge for the first time on

appeal; 2) determine the constitutionality of the "Period of Limitations" set forth in Rule 51 of the State Bar Rules of Procedures; and 3) determine whether a party may "ratify" an agreement reached solely through his counsel without ever having "full knowledge of the material facts." Alternatively, Petitioner requests that this matter be stayed pending the issue of a final decision in the pending federal action entitled *Canatella v. California*.

DATED: October 14, 2002.

Respectfully submitted,
PRINCE & HEUER
A Professional Law Corporation

By: /s/ Henry T. Heuer
HENRY T. HEUER
Attorneys for Petitioner,
CHARLES CONNELL McCARTHY.

[14] **VERIFICATION**

I, CHARLES CONNELL McCARTHY, am the Petitioner in this proceeding. I have read the foregoing Petition and know the contents thereof. The factual statements set forth in the Petition are within my personal knowledge and I know them to be true.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this verification was executed on the fourteenth day of October, 2002 in Los Angeles, California.

/s/ Charles Connell McCarthy
CHARLES CONNELL McCARTHY

[15] BRIEF IN SUPPORT OF PETITION FOR WRIT OF REVIEW

STANDARD OF REVIEW

In reviewing a Review Department opinion, this Court "undertakes an independent determination of the law, and the facts, exercises its inherent jurisdiction over attorney discipline, and enters the first and only disciplinary order." (*In re Rose* (2000) 22 Cal.4th 430, 436.) "The charges against an attorney must be supported by convincing proof and to a reasonable certainty; inferences leading to a conclusion of innocence must be drawn if equally reasonable but conflicting inferences may be drawn from the evidence." (*Sternlieb v. State Bar* (1990) 52 Cal.3d 317, 324.)

LEGAL DISCUSSION

I

THE STATE BAR CANNOT IDENTIFY THE FACTUAL BASIS OF A PURPORTED "MORAL TURPITUDE" VIOLATION FOR THE FIRST TIME ON APPEAL

A. The Allegations Set Forth in the Notice of Disciplinary Charges

Count One of the NDC alleges that McCarthy committed an act involving moral turpitude in wilful violation of Business and Professions Code Section 6106[5] as follows.

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[5] The United States Court of Appeal for the Ninth Circuit recently decided the case of *Canatella v. California*, 2002 U.S. App. LEXIS 18468, which has been remanded for a determination whether, *inter alia*, California Business & Professions Code Section 6106 is unconstitutional on its face for vagueness and overbreadth in violation of the First and Fourteenth Amendments of the United States Constitution.

[16] • On or about July 27, ***1988***, McCarthy, acting in his capacity as Kau general partner, notified all the Kau limited partners that he intended to make preliminary distributions. (NDC 2:20-24.) Prior to making such distributions, McCarthy requested that all limited partners, including Ashjian, execute a release, exonerating McCarthy from any liabilities as general partner. (NDC 2:23-27.) However, McCarthy did not have the right to require Ashjian to sign a release as a precondition to receiving his Kau distribution. (NDC 3:7-9.)

- Ashjian refused to sign the release and McCarthy made distributions to everyone except Ashjian. (NDC 3:1-4.)

- McCarthy did not distribute Ashjian's share (approximately $20,946.00) of the Kau profits. (NDC 3:15-17.)

Based on these allegations, Count One then concluded that McCarthy "dishonestly or with gross negligence misappropriated the Ashjian distribution" (NDC 4:12-13) and thus "committed an act involving moral turpitude, dishonesty or corruption." (NDC 4:14-16.)

B. These Vague Allegations are Constitutionally Inadequate

Both in his Motion to Dismiss and on appeal, McCarthy argued that these allegations of 'moral turpitude' were constitutionally inadequate and requested that Count One be dismissed. "Whether conduct may properly be characterized as an act involving 'moral turpitude' is a

question of law to be determined by the court." (*Chadwick v. State Bar* (1989) 49 Cal.3d 103, 109.) This Court has also recognized that the term 'moral turpitude' cannot be defined with precision. (*Id.* at 103.) Moreover,

> because the right to practice a profession is sufficiently important to warrant legal and constitutional protection the term ***must*** be given a ***meaning and content relevant to the attorney's fitness in practice***. (*Schware v. Board of Bar Examiners* (1957) 353 U.S. 232, 239; *Morrison v. State Bd. of Education* (1969) 1 Cal.3d 214, 239 (emphasis added).)

For these reasons, this Court has previously made clear that charges [17] of 'moral turpitude' must contain ***specific*** allegations of such conduct:

> Once again we are constrained to call to the attention of the State Bar Court the importance of ***identifying with specificity*** both the rule or statutory provision that underlies each charge and ***the manner in which the conduct allegedly violated that rule or statutory provision***. . . . This specificity is also ***essential to meaningful review*** of the recommendation of the State Bar Court. (*Baker v. State Bar* (1990) 49 Cal.3d 804, 816 (Emphasis added).)

Indeed, the State Bar has facially acknowledged this obligation by adopting Rule 101(b) (1) (2) and (3) of the Rules of Procedure of the State Bar of California ("Rule 101(b)"), which require that:

> (b) The notice of disciplinary charges shall:
>
> (1) Cite the statutes . . . alleged to have been violated, or to warrant the action proposed.

(2) Contain a statement of facts constituting the alleged violations ***in sufficient detail to permit the preparation of a defense***.

(3) Relate the alleged facts to specific statutes . . . alleged to have been violated or to warrant the action proposed.

In this case, despite this Court's aforementioned pronouncements and the State Bar's own rules, the NDC merely stated the conclusion: "[McCarthy] dishonestly or with gross negligence misappropriated the Ashjian distribution." (NDC 4:12-13.) Although specifically required by *Baker*, as the Review Department admitted (p. 3, n.2), there were ***no allegations*** in the NDC as to the ***manner*** in which such misappropriation allegedly took place, and no allegations that McCarthy breached any fiduciary duty to Ashjian.[6] Moreover, the State Bar's discovery responses [18] at that time indicated that there were also ***no facts or evidence***[7] of any misappropriation.

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[6] The Review Department erroneously asserted that McCarthy "acknowledges in his opening brief on review that he was charged with breaching his fiduciary duties to Ashjian." There is no such acknowledgment in McCarthy's opening brief or any other document.

[7] McCarthy propounded Special Interrogatories to the State Bar. Interrogatory 6 asked the State Bar to "Please state with specificity all facts which you contend support or concern the allegations of Paragraph 12 of the [NDC] that McCarthy 'dishonestly or with gross negligence misappropriated the Ashjian distribution.'" The OCTC's Response (Ex. WWW, 4:17-23) stated only: "a. Subsequent to July 27, 1988, Ashjian has not received any monies from the distribution of funds from the Kau-Kong Land Company. b. [McCarthy] informed Ashjian at McCarthy's January 10, 1997 deposition that [McCarthy] no longer had any money." Interrogatory 7 asked the State Bar to "Please state with specificity all facts which you contend support or concern the allegations of Paragraph 13 of the [NDC] that: By misappropriating at

(Continued on following page)

McCarthy respectfully submits that it was not, and is not, enough to allege in vague, conclusory terms (as the OCTC did in this case) the mere act of "misappropriation." Rather, as required by this Court in *Baker* and by Rule 101(b), the NDC must identify "***with specificity*** both the rule or statutory provision that underlies each charge and ***the manner in which the conduct allegedly violated that rule or statutory provision***. . . ." and "contain a statement of facts constituting the alleged violations ***in sufficient detail*** to permit the preparation of a defense."

In denying the Motion to Dismiss, the Hearing Department did not address the California Supreme Court's holding in *Baker* (or any of the other legal authorities presented) but simply found that the allegations in the NDC were sufficient. (Order Denying Motion to Dismiss, 1:17-25.)

[19] On appeal to the Review Department, McCarthy renewed his objections to the OCTC's lack of specificity in both the NDC's allegations and corresponding discovery responses. The Review Department's refusal to reverse the Hearing Department on such grounds would, by itself, present an important question of law and casts serious doubt as to both the fairness of the hearing that McCarthy received and the State Bar's jurisdiction to consider Count One. Though either of these grounds would have justified review by this Court, as described in detail in the next section, what truly makes this case ripe for review is the

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least $20,946 of the Kau-Kona distribution funds, [McCARTHY] committed an act involving moral turpitude, dishonesty or corruption.'" The OCTC's response merely repeats the conclusory allegation: "[McCarthy] misappropriated at least $20,946.00." (Ex. WWW, 4:24-25.)

step taken by the Review Department to compound this error.

C. Finding Culpability on Facts Identified for the First Time on Appeal Violates McCarthy's Right to Due Process

The State Bar cannot impose discipline for a violation that is not alleged. (*Van Sloten v. State Bar* (1989) 48 Cal.3d 921, 928.) To find an attorney culpable "based on uncharged misconduct would be a violation of due process." (*Lipson v. State Bar* (1991) 53 Cal.3d. 1010, 1018 (setting aside finding of culpability on § 6106 "moral turpitude" charge).)

Here, McCarthy's fears – as echoed by this Court in *Chadwick*, *Baker*, and *Morrison* and by Rule 101(b) – about not receiving adequate notice as to what, if any, of his conduct over the many years since October 1967 (when Kau was formed), constituted "moral turpitude" were borne out. Because the NDC and the OCTC's discovery responses only asserted the vague allegation that McCarthy had "misappropriated the Ashjian distribution," the Review Department was able to – and did – invent a wholly new theory of culpability that the OCTC had never advanced in the [20] NDC, in its discovery responses, or at trial:

> [W]e need not and do not decide whether the funds which respondent took belonged to Ashjian or to Kau. . . . Because the evidence establishes that ***respondent took his [own] share*** of the final distribution without ever having paid Ashjian his share of the preliminary distribution, we conclude that at the time of the final disbursement . . . ***respondent was culpable of***

> ***willfully misappropriating funds*** to which Ashjian was entitled. (Rev. Dept. Opin., p. 15 (emphasis added).)
>
> [W]e ***need not determine whether . . . respondent breached his fiduciary duty to Ashjian by requiring a release*** from all limited partners before disbursing funds pursuant to the preliminary distribution plan [and] assum[e] for the sake of argument that respondent was ***entitled to withhold the funds at the time of the preliminary distribution due to Ashjian's refusal to sign the release***. . . (Rev. Dept. Opin., p. 25 (emphasis added).)

In this case, the conduct purportedly constituting "moral turpitude" – simply McCarthy's receipt of his own partnership distribution before paying Ashjian his distribution – as opposed to the actual misappropriation" that was alleged in the NDC and perpetuated by the Hearing Department[8] – was not identified by the State Bar until the Review [21] Department's opinion.[9] In finding

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[8] The Hearing Department led everyone to believe that McCarthy's own distribution was a non-issue and that ***only*** Ashjian's distribution was at issue: "So the state of the record now is that there was essentially a fair and equal attempt to distribute the partnership distribution." (RT, 1-174:25175:5.) "Well again, no one has any complaints about the partnership agreement or the way Mr. McCarthy ran the partnership. This is all about this ***one*** distribution issue, and I think we really need to focus on that. . . This is really about this ***one*** distribution issue." (RT, 11-11:7-14 (emphasis added).)

[9] Because it assumed in its decision that the release was proper, and because the State Bar cannot contradict its judicial admission that Ashjian refused to sign the release (NDC 3:1-2; *Evidence Code* § 1220-1227; *Smith v. Walter E. Heller & Co.* (1978) 82 Cal.App.3d 259, 269), it is respectfully submitted that the Review Department, in its apparent haste to find McCarthy culpable of *something*, has cast a version of the

(Continued on following page)

McCarthy culpable of an act of "moral turpitude" that was not even alleged in the NDC or specified in the OCTC's discovery responses and recommending his suspension, the State Bar has violated McCarthy's right to due process. Certainly, this case presents an "important question of law" that this Court should review and resolve in McCarthy's favor.

Similarly, because he was found culpable for conduct that was not even identified until this case was on appeal, McCarthy could not have received – and did not receive – a fair hearing, and to the extent that the State Bar purports to find a respondent such as McCarthy culpable, it acts without jurisdiction. The OCTC was obligated but failed to set forth the "facts constituting the alleged violations ***in sufficient detail*** to permit the preparation of a defense." This failure to disclose such facts was compounded when the OCTC served discovery responses that also failed to disclose that the conduct in question was McCarthy's receipt of his own partnership distribution. As a result, the purported determination of culpability was a sham. McCarthy's receipt of his own partnership distribution had not been raised, was not in issue, and McCarthy could not [22] possibly prepare or present a defense on this unalleged conduct.[10] Accordingly, this Court should review this case and resolve it in McCarthy's favor.

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facts in which Ashjian even now, is not entitled to receive his preliminary distribution. If Ashjian is not yet entitled to receive his preliminary distribution, then McCarthy has committed no wrongdoing in allegedly not distributing it to him.

[10] The Review Department's creation of a new factual predicate was apparently the only way to avoid addressing McCarthy's

(Continued on following page)

II

THE PERIOD OF LIMITATIONS SET FORTH IN STATE BAR RULES OF PROCEDURE RULE 51 IS UNCONSTITUTIONAL

A. The Constitutional Test

This Court has recently set forth what is required to prevail on [23] McCarthy's claim that Rule 51 of the State Bar Rules of Procedure is unconstitutional on its face and/or as applied to him in this case:

> When, as here, the contention is that a ***state rule violates due process***, the defendant must show that the rule '***offends some principle of***

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affirmative defenses with respect to the purported impropriety of the release. Notably, *Bryden* provided an explicit judicial imprimatur of propriety of the release upon which McCarthy was entitled to rely (*see Bulmash v. Davis* (1979) 24 Cal.3d 691, 698; *In re Lisa R.* (1975) 13 Cal.3d 636, 645). In addition, requiring a release was a discretionary decision made only after first consulting with Kau's attorney (Bullis) and with a trusted business advisor (Schiller). (*See* Chodos, *The Law of Fiduciary Duties* (Blackthorne 2000) p. 154 (courts "will not 'second-guess' the fiduciary or act as a 'Monday-morning quarterback' to him"); *Wyler v. Feuer* (1978) 85 Cal.App. 3d 392, 403-04; *Wallner v. Parry Professional Bldg., Ltd.* (1994) 22 Cal.App.4th 1446, 1451; *Baldwin v. Marina City Properties, Inc.* (1978) 79 Cal.App.3d 393, 411; *Findley v. Garrett* (1952) 109 Cal.App.2d 166, 178-79; *Marsili v. Pacific Gas & Electric Co.* (1975) 51 Cal.App.3d 313, 324.) Moreover, in light of his having carefully sought out advice from Bullis and Schiller, and in light of *Bryden*, McCarthy could not have been acting "dishonestly or grossly negligence" (in continuing to require Ashjian to sign the release) as was alleged, but at worst could have been guilty of "poor judgment as to the law," which is not subject to discipline. (*Butts v. State Bar* (1948) 31 Cal.2d 453, 457; *In re Respondent P* (1993) 2 Cal. State Bar Ct. Rptr. 622; *In re Hertz* (1991) 1 Cal. State Bar Ct. Rptr. 456.)

> ***justice so rooted in the traditions and conscience of our people as to be ranked as fundamental.'*** [citations] Fundamental principles of justice are those that 'lie at the base of our civil and political institutions' and ***'define the community's sense of fair play and decency.'*** (*City of Los Angeles v. Superior Court (Brandon)* (2002) 29 Cal.4th 1, 16.)

Here, it is respectfully submitted that one of our "fundamental principles of justice" is the statute of limitations and its attendant "purpose to protect defendants from the stale claims of dilatory plaintiffs." (*Norgart v. Upjohn Co.* (1999) 21 Cal. 4th 383, 395.) "[I]n accord with 'public policy' [citations] [a statute of limitations] 'promote[s] repose by giving security and stability to human affairs.'" (*Norgart*, 21 Cal.4th at 396.) Thus, according to Witkin, "statutes of limitation are vital to the welfare of society. . . They are found and approved in all systems of enlightened jurisprudence." (3 Witkin, CAL. PROC. (4th Ed. 1997) *Actions* § 408, p. 513.)

Accordingly, as described in greater detail below, it is respectfully submitted that McCarthy's due process rights were indeed violated by Rule 51, which provides that a State Bar disciplinary proceeding ***"shall*** be initiated within five years from the date of the alleged violation."[11]

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[11] In addition, however, Rule 51 provides that any alleged violation is "deemed to have been committed when every element of the alleged violation has occurred, except where the alleged violation is a continuing offense, in which case the violation is deemed to have been committed at the termination of the entire course of conduct." Rule 51(c) also contains 11 separate tolling provisions.

[24] **B. Analysis**

1. The Denial of the Motion to Dismiss Count One was Unconstitutional.

The NDC in this case specifically alleged that the purported violation that is the subject of Count One took place in ***1988***. (NDC 2:20-27; 3:7-9.) Ashjian did not submit a complaint to the State Bar until January 23, 1996 (NDC 4:26-28), nearly eight years later. The OCTC in turn waited nearly four years before filing the NDC on November 24, 1999. In total then, the NDC was ***not filed until over 11 years after the alleged misconduct took place***. In light of the tardy filing of the NDC, McCarthy brought a Motion to Dismiss on the ground that Count One was untimely and should have been dismissed pursuant to State Bar Rules of Procedure, Rule 262.

In denying this motion, the Hearing Department characterized McCarthy's obligation to make Ashjian's distribution as being of a "continuing nature"[12] (Order Denying Motion to Dismiss, 1:27) and thus ruled that the Period of Limitations did not begin to run in 1988 when the alleged wrong actually occurred. Instead, the Hearing Department found that McCarthy "apparently held the monies in trust a[t] least until 1996. . . . well within the statute of limitations." (Order Denying Motion to Dismiss, 1:28-2:7.) Because a Motion to Dismiss in the State Bar Court is necessarily confined by rule (*i.e.*, Rule 262(c) of the Rules of Procedure) to a "Defective Initial Pleading," in

[12] To the contrary, the NDC alleges only a single occasion of "misappropriation." (NDC 4:12-13.)

ruling on such a motion the Hearing Department was limited to the initial pleading only. However, there was no allegation that McCarthy held any monies in trust for Ashjian until at least [25] 1996. Nevertheless, that was the stated ground for denying the motion. Because its ruling rested solely on an unalleged fact, the Hearing Department improperly refused to dismiss Count One against McCarthy on Period of Limitations grounds. Under *Lipson* and *Van Sloten*, this misapplication of the State Bar's Period of Limitations is unconstitutional.

2. The Hearing Department Opinion

Following trial (in which the OCTC elicited testimony as to events dating back to 1965 (RT, I-33:12)), the Hearing Department found that the K1 forms[13] for Kau that McCarthy provided somehow concealed[14] and delayed

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[13] When McCarthy's counsel attempted to introduce business records that would have explained "what the [capital account] figure on the K-1 represented," the Hearing Department refused to allow such evidence:" I'm not going to allow it. You know, really, I think the whole capital account issue is a red herring, in any case." (RAT, II-180:21-23.) After making this and other misleading statements, the Hearing Department then used the "whole capital account issue" to find that the NDC was timely filed. (Culpability Ruling, 2:4-11.)

[14] Under Rule 51(c)(4), the concealment of "facts constituting the violation" tolls the running of the Period of Limitations. However, the dissipation of Kau's cash was not (and could not have been) "concealed" by anything appearing on the K1 forms. Ashjian, a certified public accountant, admitted at trial that a "capital account does not mean cash." (RT, I-120:3.) Any change in Ashjian's capital account simply represented an "accounting decision" made by McCarthy on Kau's dissolution in consultation with Kau's accountant, Richard Hyde, that any positive capital accounts would be reduced to zero and show an ordinary loss that could be used as a deduction by all the Kau partners.

(Continued on following page)

Ashjian's discovery of the alleged "moral turpitude" committed by McCarthy until 1996 "when it was clear the money was gone." (Culpability [26] Ruling, 2:4-11.) Neither the facts nor the law support such a conclusion, because under the 'discovery rule,' the running of a statute of limitations is only postponed:

> until the plaintiff discovers or has reason to discover, the cause of action. [citation] [¶] [T]he plaintiff discovers the cause of action when he at least suspects a factual basis, as opposed to a legal theory, for its elements, even if he lacks knowledge thereof – when, simply put, he at least '***suspects ... that someone has done something wrong***' to him [citation] ... He has reason to discover the cause of action when he has a reason to suspect a factual basis for its elements [citation]. He has reason to suspect when he has '***notice or information of circumstances to put a reasonable person on inquiry***' [citation]; he need not know the 'specific facts' necessary to establish' the cause of action.... but, within the applicable limitations period he ***must indeed seek to learn the facts necessary to bring the cause of action in the first place – he 'cannot wait for' them 'to find' him and 'sit on' his 'rights;' he 'must go find' them himself***.... (*Norgart*, 21 Cal.4th at 397-98 (emphasis added).)

In this case, Ashjian apparently suspected that McCarthy had 'done something wrong to him' as early as

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(RT, II-112:22-113:3; 113:14-20.) Hyde, however, was not permitted to testify.

August 5, 1988, when he stated: "There is no excuse morally or by reason of law not to distribute my share of the money. Your recent actions have done nothing but create more ill feeling when such action was not warranted."[15] (Ex. 6.) Moreover, by August 18, 1988, Ashjian was suspicious enough to have retained counsel at a major law firm to represent him. (Hearing Dept. Opin., 3:12-13; Ex. BBBB.) Thus, regardless of the K1 forms, Ashjian was on notice of the [27] purported wrongful act against him as early as August 1988.[16] Therefore, the NDC was untimely filed.

3. The Review Department Opinion.

Even the Review Department's switching of the factual predicate cannot defeat the period of limitations defense. By redefining the purportedly wrongful conduct to be of a non-continuing nature, to wit, McCarthy's paying his own distribution, the period of limitations began to run in 1993, when Ashjian could purportedly assert a claim for a constructive trust (*Lezinsky v. Mason Malt Whiskey Distilling Co.* (1921) 185 Cal. 240, 244) and had expired by the time the NDC was filed in 1999.

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[15] Ashjian could and should have sought to "learn the facts" as to Kau's financial records, as he was entitled to do. (Ex. 2, Art. VIII(c) p. 11.)

[16] Alternatively, Ashjian readily acknowledged that he had received written notice that Kau's "business and affairs had been completed" by early May 1993. (RT, I-107:9-19.) Even using this later date, however, the NDC was still untimely filed over six years later.

4. McCarthy Could Not Possibly Obtain a Fair Trial 12 Years After the Alleged Misconduct

"Statutes of limitations and the equitable doctrine of laches constitute a recognition that claims can become stale – documents may be lost and memories fade over time." (*Sequeira v. Rincon-Vitova Insectaries, Inc.* (1995) 32 Cal.App.4th 632, 637.)

In this case, McCarthy was forced to stand trial in June 2000 on a disciplinary charge that alleged wrongdoing some 12 years prior, in July 1988. Although McCarthy asserted the defense of the expiration of the period of limitations, Kau's retired accountant, Hyde, who could have [28] explained the capital accounts and K1 forms (later characterized by the State Bar as "concealed" facts), was unavailable to testify in person, and the Hearing Department refused to permit him to testify by telephone as his wife was undergoing major surgery. While it would be difficult for anyone at any age to be able to testify as to events that were 12 years old or even 33 years old (the formation of Kau), McCarthy was nearly 78 years old at the time of trial. The prolonged delay in filing the NDC – as permitted by the tolling provisions of Rule 51 – so hampered McCarthy's ability to put on his defense that it was impossible for him to obtain a fair hearing so many years removed from the actual events in question. Indeed, under Rule 51's tolling provisions, the NDC could possibly be filed even now – as McCarthy is 80 years old and should be spending his golden years' with his grandchildren – in light of Ashjian's five-year delay in obtaining a judgment on his adversary proceeding in bankruptcy

court. Thus, Rule 51 can and did toll the period of limitations for an unconstitutionally long time and preclude the very "security and stability to human affairs" it promotes.

Accordingly, it is respectfully submitted that this Court grant review and determine that the period of limitations set forth in Rule 51 is unconstitutional on its face and/or as applied to McCarthy in this case.

III

A PARTY CANNOT "RATIFY" AN AGREEMENT REACHED SOLELY THROUGH COUNSEL WITHOUT "FULL KNOWLEDGE OF MATERIAL FACTS"

Under California law, an unauthorized act by agent "may be [29] rendered valid and binding upon the principal, as of the time the unauthorized act was done, if he ratifies and thus gives effect to it." (2 Witkin, SUMMARY OF CAL. LAW (9th Ed. 1987 and 1999 Supp) *Agency and Employment* § 87, p. 88.) Typically, ratification is accomplished by voluntary acceptance of the benefits of the transaction by the principal (*Civil Code* § 2310), provided that the principal has

> ***full knowledge of the material facts***, and at the time the principal learns of the unauthorized act he must be in a position to reject it. . . .
>
> (2 Witkin, SUMMARY OF CAL LAW (9th Ed. 1987 and 1999 Supp.) *Agency and Employment* § 89, p. 89 (emphasis added).)

Without "full knowledge of the material facts," there can be no ratification and "even an express ratification may be rescinded." (2 Witkin, SUMMARY OF CAL. LAW (9th Ed. 1987 and 1999 Supp.) *Agency and Employment* § 92, p.

91.) Moreover, "an act wholly void for illegality cannot be ratified." (*Id.* (*citing Bear River Sand & Gravel Corp. v. Placer* (1953) 118 Cal.App.2d 684, 689).)

In this case, the Hearing Department concluded that McCarthy "ratified his attorney's position by relying upon it and/or failing to repudiate it at any time." (Hearing Dept. Opin., 8:14-16.) However, McCarthy was completely unaware of a most material fact: including the withdrawal of this State Bar proceeding was improper under Section 6090.5 (nor was he so informed by Felton). (RT, I-152:8-9.) Because the improper nature of even negotiating for such an act is also a 'material fact' that was unknown to McCarthy, for this reason too, there could be no ratification. (RT, I-154:3-6; I-154:18-20.) Unless or until he was apprised by his counsel of these material facts, McCarthy would not even be in a position to "repudiate." (RT, I-154:7-17.) Finally, because withdrawal of a State Bar [30] complaint is illegal, an agreement that allegedly included such a provision is void and could not be ratified as a matter of law.

Accordingly, this Petition presents an important question of law: whether a party may "ratify" an agreement reached solely through his counsel without ever having "full knowledge of the material facts." In addition, it is respectfully submitted that there is insufficient evidence to support the conclusion that McCarthy "ratified" any such agreement.

CONCLUSION

For each of the foregoing reasons, Petitioner, CHARLES CONNELL McCARTHY, respectfully requests that this Court issue a writ of review to: 1) determine the

propriety of identifying the purported factual basis for a "moral turpitude" disciplinary, charge for the first time on appeal; 2) determine the constitutionality of the "Period of Limitations" set forth in Rule 51 of the State Bar Rules of Procedures; and 3) determine whether a party may "ratify" an agreement reached solely through his counsel without ever having "full knowledge of the material facts." Alternatively, Petitioner requests that this matter be stayed pending the issue of a final decision in the pending federal action entitled *Canatella v. California*.

DATED: October 14, 2002.

Respectfully submitted,
PRINCE & HEUER
A Professional Law Corporation

By: /s/ Henry T. Heuer
HENRY T. HEUER
Attorneys for Petitioner,
CHARLES CONNELL McCARTHY

* * *

APPENDIX F

McCarthy & Bullis
ATTORNEYS AT LAW
AN ASSOCIATION INCLUDING
A PROFESSIONAL CORPORATION
2029 CENTURY PARK EAST, SUITE 1690
LOS ANGELES, CALIFORNIA 90067
(213) 475-0430
July 27, 1988

CHARLES C. MCCARTHY
WILLIAM M. BULLIS*
*A PROFESSIONAL CORPORATION

TO: THE LIMITED PARTNERS OF KAU-KONA LAND CO.

The all cash sale of our land for $5,250,000 closed on June 13, 1988, with disbursement of $4,373,022.32 to Kau-Kona Land Co. per Seller's Closing Statement, a copy of which is enclosed. The proceeds of sale were immediately deposited to a premier money market account.

On Friday, July 1, 1988, the Bankruptcy Court granted our Motion To Dismiss Case thus removing us from its jurisdiction.

We are therefore in a condition requiring us to address the subject of dissolution, central to which is an assessment of Partnership assets and liabilities, both known and unknown.

Potential assets, other than the proceeds of sale, include the possible realization of monies from:

1) *Delfarm*, incident to our paying $27,000 toward the purchase of 3,000 macadamia nut trees in July, 1983; we just might end up with

some cash and/or some macadamia nut trees which we could sell; and

2) *Quest Investment Corp.*, the purchaser of our land incident to the inclusion of our rights in Kono Water Source Agreement I as part of the purchase, dependent on Quest's disposition of the water rights – it's a long shot.

But coping with the realization of assets is easier by far than coping with liabilities, for the latter are virtually undistributable to Limited Partners! To be candid, I must be prudent or risk "holding the bag" for I am personally liable for 11 obligations of the Partnership whether presently known or unknown!

Events of the past few years have made me painfully aware of my personal liability as the sole legal and de facto underwriter of Kau's affairs. In order to keep our operations afloat, I've had to advance substantial sums of my own cash as you know and I've had to expose myself to very substantial personal liability for all variety of things including the services of accountants, attorneys, appraisers, surveyors, etc., etc., etc. On March 10, 1988, judgment against me and my wife for $386,673.90 was entered in the First Circuit Court of Hawaii on our personal guarantees of the Sterling Bank loan. On April 21, 1988, Sterling proceeded against us in California on the Hawaii judgment.

There follows a summary of potential Partnership liabilities:

1) *Deed Warranties and – the obligation to "Defend* . . . the Grantee against the lawful claims and demands of all persons claiming by, through, or under the Grantor . . .;"

2) *Citisavings* which, as you know, on June 1, 1988 filed a Complaint in the First Circuit

Court of Hawaii, against me, Leon Daniell and Larry Lopez for costs, fees and expenses in the sum of $85,160.48 net of our payment of $15,000 thereon and our payment of $10,000 as loan fees – Citisavings just might sue the Partnership;

3) *Unknown Claims*, possibly for finder's fees or real estate brokerage commissions for example; and

4) *Claims of Limited Partners* which requires more comprehensive consideration.

Assessing the prospect of claims against me as General Partner and/or against the Partnership has been compounded by the manifest litigious proclivities of a very few "Limited Partners." Ironically, not one of them is an *original* Limited Partner! Rather, their status is that of an "assignee" or "successor." Nonetheless, they have played a very active role in the Kau Bankruptcy proceedings.

Recently, their counsel filed Objections on which you were copies) to payment of fees and reimbursement of costs to Kau's counsel, which were vigorously asserted in open Court on June 2, 1988. The Court ordered fees to Kau's counsel reduced by all of *$659* but otherwise approved fees in the amount of *$34,238.38* plus costs of *$3,544.04*. A copy of the Order is enclosed.

Most recently, their counsel filed a voluminous Memorandum (on which you were also copied) in Opposition to Kau's Motion to Dismiss Case from Bankruptcy, again followed by vigorous opposition in open Court on Friday, July 1, 1988. Notably, not one but two partners of the law firm representing Citisavings were also then present in Court, to add their voices in vigorously opposing Kau's dismissal from Bankruptcy. *Immediately* following oral argument, the Court ordered dismissal.

Opposing the payment of fees and dismissal from Bankruptcy was a waste of time and money for all parties because the results were predictable. This is particularly so as to dismissal, for it was but six months ago, on January 15, 1988, that the same judge, in the same Courtroom, overruled essentially the same objection, by the same parties, to the dismissal of Puapuaa (which likewise had no creditors) from Bankruptcy.

The events referred to above suggest not only a predisposition to legal adventurism but also portends a dispute of significant proportions having to do with the interpretation of the tax, accounting and distribution provisions of the Kau-Kona Land Co. Limited Partnership Agreement.

To better understand the nature and magnitude of the dispute you should closely peruse their Memorandum In Opposition to Dismiss Case, most particularly Exhibits C through E thereof.

At the request of their counsel, Kau's accountant, C.P.A. Richard M. Hyde and I met with their "designated hitter," Ronald Neuhoff, Esq. in my offices on Thursday, June 16, 1988. During the course of a 2-hour conference, Mr. Hyde explained the substance of Schedules A & B of Exhibit C (copies enclosed) which were discussed if not debated in depth as were Mr. Neuhoff's contentions.

Noteworthy is the fact that their counsel never complied with Paragraph 1, Page 1 of Exhibit C by providing *written objections* to the proposed distribution with a *written counter-proposal*. We were unaware of the Deloite, Haskins & Sells opinion letter of June 28, 1988 (Exhibit E of the Memo in Opposition) until served with their Memo

two days before the matter was heard at 9:30 a.m. on Friday, July 1, 1988.

It is neither feasible nor appropriate for me to here attempt an exegesis involving the legal interpretation of contracts and esoteric accounting concepts. If you wish to have a more definitive understanding of this matter, I suggest that you seek your own counsel.

As the one who drafted the Partnership Agreement and lived with and by its terms for the past 20 years, I am convinced that Mr. Hyde's treatment of profits and losses in Schedules A and B is correct in principal.

So as to be consistent with the Order Authorizing Partial Distribution and not disappoint your expectations, I shall effectuate a preliminary distribution of $2,094,600 to the Limited Partners. A preliminary distribution of $1,847,345 shall be made to the General Partnership interest, leaving an undistributed balance of $332,055 in which the Limited and General Partners shall have a 60%/40% interest respectively, as shown in the enclosed Summary of Preliminary Distribution.

Accordingly, I shall make distribution to you as set forth in Exhibit A of the Motion (copy enclosed), *PROVIDED* you first sign and return the enclosed Warranty, etc.

In view of the status of Partnership assets and contingent liabilities referred to above, it would be imprudent of me to distribute all of the Partnership's cash at this time.

This is particularly so as to Limited Partners possessed of a litigious bent. They just might cash their distribution checks without objection, then sue or threaten

to sue me for making improper distribution – *after all of the money is gone*!

Let's clear the decks by either signing the enclosed Warranty, etc., or informing me of any claims against me, in which case individual distributions shall be withheld until final resolution of any dispute.

As time passes in the course of winding up the affairs of the Partnership, I shall be better able to determine when the remaining balance of cash may be prudently distributed and the Partnership dissolved. Obviously it can't be done now.

Very truly yours,
/s/ Charles C. McCarthy
CHARLES C. McCARTHY
General Partner

CCMc/pl

Enclosures

P. S. Mr. Hyde is now in the process of preparing the Partnership's 1987 Income Tax Returns and the year-end statements from December 31, 1984 through December 31, 1987. Your K-1 should be in the mail within 10 days.

FIRST AMERICAN TITLE COMPANY
OF HAWAII, INC.

ESCROW NUMBER: 10647-sk
PROPERTY: Queen Kaahumanu Hwy.
.0

TODAY'S DATE: 6/09/88
CLOSING DATE: 6/13/88

TMK: (3) 7-2-5-1

ESCROW CLOSING STATEMENT OF:
Kau-Kona Land Company

SELLER'S CLOSING STATEMENT

DESCRIPTION		DEBITS	CREDITS
Sales Price			5,250,000.00
Delinquent 1985-1986, 1986-1987 & 1987-1988 taxes Plus Penalty and Interest		2, 281.87	
Prorate County Taxes 6/13/88 to 7/01/88 @ $270.54/6 mos.			27.00
First Mortgage payoff Sterling Bank		858,899.76	
Principal balance	<$590,000.00		
Interest thru 6-15-88	< 212,533.35		
Late Fees	< 29,500.00		
Legal Expenses	< 26,741.41		
Reconveyance Fee	< 125.00		
Wiring Charge to First Hawaiian Bank		50.00	
Accommodation Escrow Fee (½) First American Title Insurance Company, Santa Ana, California		200.00	
NOTE: All closing & escrow costs to be shared equally between Seller & Buyer with exception of Title Search and Title Policy.			
Escrow Fee to FAM Santa Ana, Ca.			
Title Search/Policy			
FIRST AMERICAN TITLE CO OF HI		8,662.50	
Escrow fee			
FIRST AMERICAN TITLE CO OF HI		5,547.00	
Tax Search Blue Sky Enterprises		1.10	
Drafting of Warranty Deed handled outside of Escrow.			
Staking – Handled Outside of Escrow			
Conveyance Tax to State of Hawaii (½)			
Conveyance Tax on $5,250,000. BUREAU OF CONVEYANCES		1,312.50	
Recording fee BUREAU OF CONVEYANCES		50.00	
Balance Due To Seller disbursed by First American Title Company, Santa Ana, Calif.		4,373,022.32	
TOTALS		5,250,027.05	5,250,027.00

This statement should be retained by you for Income Tax purposes.

Of Counsel:
CASE & LYNCH

TOD Z. TANAKA 3262-0
Suites 2500 and 2600
Grosvenor Center, Mauka Tower
737 Bishop Street
Honolulu, Hawaii 96813
Telephone No. 547-5400
Attorney for Debtor

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF HAWAII

IN RE:	CASE NO. 86-00438
KAU-KONA LAND CO.,	(Chapter 11)
Debtor.	ORDER APPROVING PAYMENT OF COMPENSATION AND REIMBURSEMENT OF EXPENSES TO COUNSEL FOR DEBTOR
	(Filed Jun. 20, 1988)

6585F

ORDER APPROVING PAYMENT OF COMPENSATION AND REIMBURSEMENT OF EXPENSES TO COUNSEL FOR DEBTOR

The Application for Approval of Payment of Compensation and Reimbursement of Expenses to Counsel for Debtor filed herein on May 13, 1988 came on for hearing before this Court on June 2, 1988. Tod Z. Tanaka, Esq. appeared for the Debtor and Applicant Case & Lynch; James A. Wagner, Esq. appeared for Charles C. McCarthy, the general partner of the Debtor; Barry G. Ziker, Esq.

appeared for Neile McQueen Toffel, McQueen Children's Trust, R. K. Armstrong and Sally Armstrong Miller; Eric K. H. Chinn, Esq. appeared on behalf of Martha Helen Price; and Ronald K. K. Sakimura, Esq. appeared on behalf of Sterling Bank. The Court having reviewed the Application, the record and file herein, and having considered the arguments of counsel, and good cause appearing therefor,

IT IS HEREBY ORDERED that the Application for Approval of Payment of Compensation and Reimbursement of Expenses to Counsel for Debtor is approved, subject to the deletion of 6.1 hours of attorney's time, specifically 2.0 hours entered on December 11, 1987 by David C. Farmer at the rate of $90.00 per hour, 2.1 hours entered on December 14, 1987 by David C. Farmer at the rate of $90.00, and 2.0 hours entered on February 10, 1988 by Ray K. Kamikawa at the rate of $145.00. All other fees and expenses requested by Applicant are approved. The Debtor is authorized and directed to pay to Case & Lynch the sum of $34,238.38 as compensation for its fees, including tax, and to reimburse to Case & Lynch the sum of $3,544.04 for costs advanced, including tax, or a total sum of $37,782.42.

DATED: Honolulu, Hawaii, JUN 16 1988.

DON J. CHINEN
Judge of the above-entitled Court

SCHEDULE A

KAU-KONA LAND COMPANY

Projected Cash Distribution

	Capital Account Balance		
	Limited Partners	General Partners	Total
Balance – 12/31/86	<$ 200,774>	$ 112,720	<$ 88,054>
1987 Income <Loss>	<668>		<668>
Balance – 12/31/87	<$ 201,442>	$ 112,720	<$ 88,722>
1988 Capital Gain (1)(2)	2,801,170	1,867,447	4,668,617
1988 Income <Loss>	<305,895>		<305,895>
Balance at Close (3)	$ 2,293,833	$ 1,980,167	$ 4,274,000
Distribution			
Unrepaid Capital Contr. (4)	$ 553,000		$ 553,000
Balance Cash Available 40/60	1,258,800	1,888,200	3,147,000
Total Cash Distribution (3)	1,811,800	1,888,200	3,700,000
Cash for Contingencies	$ 482,033	$ 91,967	$ 574,000

SCHEDULE B

KAU-KONA LAND COMPANY

1. Gain on Sale of Property

Sales Price		$5,250,000
Selling Expenses	$ 50,000	
Cost Basis	531,383	
		581,383
Capital Gain		$ 4,668,617

2. Allocation of Capital Gain

Regular Limited Partners – 60%	$ 2,801,170
General & Special Limited Partners – 40%	1,867,447
Capital Gain	$ 4,668,617

3. Cash Available for Distribution

Sale Proceeds		$ 5,250,000
Expenses of Sale	$ 50,000	
Debts and Liabilities	926,000	
		976,000
Balance		$ 4,274,000
Reserve for Contingent Liabilities		574,000

Cash Available for Distribution	$ 3,700,000

4. Capital Contribution Balance

Total Contributions	$ 863,000
Previous Distribution	310,000
Balance Due Limited Partners	$ 553,000

KAU-KONA LAND CO.

Summary of Preliminary Distribution

July 27, 1988

	Limited Partners	General Partners	
Capital Balances per Schedule A	$2,293,833	$1,980,167	$4,274,000
Less: Partial Distribution*	2,094,600	1,847,345	3,941,945
Undistributed Cash on Hand	$ 199,233 (60%)	$ 132,822 (40%)	$ 332,005 (100%)

*Includes unrecouped capital contributions of $553,000

EXHIBIT A

KAU-KONA PRELIMINARY DISTRIBUTION

Limited Partners

Percentage	Limited Partner	Return of Capital	Profit Distribution	Total
5%	Armstrong, R. Clark	25,780	78,950	104,730
1%	Ashjian, Nazar J.	5,156	15,790	20,946
1%	Bender, Richard	5,156	15,790	20,946
.5%	Blue, Michael K.	2,578	7,895	10,473
.5%	Blue, William	2,578	7,895	10,473
10%	Brillingham, Baird C.	51,560	157,900	209,460
10%	Bryden Estate	51,560	157,900	209,460
2%	Bullock, Harvey	10,312	31,580	41,892
5%	Evans, Viola G.	25,780	78,950	104,730
5%	Evans Trust	25,780	78,950	104,730
1%	Goodfader, Robert W.	5,156	15,790	20,946
1%	Gordon, Hillard W.	5,156	15,790	20,946
3%	Guild Management Corp.	15,468	47,370	62,838
4.5%	Holden, Judith L.	23,202	71,055	94,257
5.5%	Keith, Robert	28,358	86,845	115,203
5%	McCarthy, Charles C.	25,780	78,950	104,730
5%	McQueen Children's Trust	25,780	78,950	104,730
1%	McHugh, James	5,156	15,790	20,946
5%	Miller, Sally A.	25,780	78,950	104,730
3%	Montalban, Ricardo	15,468	47,370	62,838
1%	Oakmont Insurance	5,156	15,790	20,946
1%	Parness, Oscar	5,156	15,790	20,946
1%	Parness, Richard	5,156	15,790	20,946
5%	Prince, Martha	25,780	78,950	104,730
10%	Saffian, Lois C., Trustee	51,560	157,900	209,460
3%	Saffian, Robert, M.D.	15,468	47,370	62,838
5%	Toffel, Neile McQueen	25,780	78,950	104,730
100%		$515,600	$1,579,000	$2,094,600

KAU-KONA LAND CO.

WARRANTY, INDEMNIFICATION AND RELEASE RE PRELIMINARY DISTRIBUTION OF PROFITS

For the purpose of inducing Charles C. McCarthy, General Partner of Kau-Kona Land Co., a California Limited Partnership, to distribute to the undersigned, his or her share of the profits of said Partnership, the undersigned does hereby:

1. *Warrant and represent* that he or she is either:

a. An original Regular Limited Partner of Kau-Kona Land Co., a California Limited Partnership; or

b. A lawful successor or assignee of a Regular Limited Partner of said Limited Partnership who shall, concurrent with the delivery of this document to said General Partner, also deliver good and sufficient evidence confirming his or her status as such lawful succesor or assignee.

In either case the undersigned does further warrant and represent that he or she is now the sole lawful holder of the interest in profits of said Partnership set forth below and that he or she will *indemnify* and *hold said Partnership and/or its General Partner free and harmless* from any damages, costs or expenses incurred incident to defending any claim(s) adverse to said interest, to wit:

A ___% share of the $2,094,600 Preliminary Distribution to Limited Partners of July 27, 1988, being the sum of $___.

2. *Release* said General Partner, his heirs or assignees from any and all claims which the undersigned may have had, now has or may, at any time in the future, have

against said General Partner, his heirs or assignees in a way relating to his stewardship of the affairs of said Partnership, whether in his capacity as General Partner, counsel or otherwise.

Executed at ___ this ___ day of July, 1988.

ENCLOSURES
KAU LETTER TO LIMITED PARTNERS

1. SELLER'S CLOSING STATEMENT
2. ORDERING APPROVING PAYMENT OF COMPENSATION AND REIMBURSEMENT OF EXPENSES TO COUNSEL FOR DEBTOR
3. PROJECTED CASH DISTRIBUTION (SCHEDULE A)
4. KAU-KONA LAND COMPANY (SCHEDULE B)
5. SUMMARY OF PRELIMINARY DISTRIBUTION
6. KAU-KONA PRELIMINARY DISTRIBUTION (EXHIBIT A)
7. WARRANTY, INDEMNIFICATION AND RELEASE RE PRELIMINARY DISTRIBUTION OF PROFITS

LETTER DATED JULY 27, 1988 TO: THE LIMITED PARTNERS OF KAU-KONA LAND CO. MAILED ON JULY 28, 1988 TO THE FOLLOWING:

ROBERT J. SMOLENSKI, ESQ.
SMOLENSKI & WOODDELL
1717 DAVIES PACIFIC CNTR.
841 BISHOP STREET
HONOLULU, HI 96813

w/Warranties to:
R. CLARK ARMSTRONG
SALLY A. MILLER
NEILE McQUEEN TOFFEL
McQUEEN CHILDREN'S TRUST

ERIC K. H. CHINN, ESQ.
ASHFORD & WRISTON
SIXTH FLOOR
235 QUEEN STREET
HONOLULU, HI 96813

w/Warranties to:
MARTHA PRINCE
(Special Ltd. Partner)
MARTHA PRINCE
(Limited Partner)

HAZAR J. ASHJIAN, JR.
16633 VENTURA BLVD., #1040
ENCINO, CA 91436

RICHARD BENDER
4936 CALVIN AVENUE
TARZANA, CA 91356

MICHAEL K. BLUE
23047 VENTURA BLVD., #100
WOODLAND HILLS, CA 91364

WILLIAM BLUE
29500 HEATHERCLIFF RD., #77
MALIBU, CA 90265

BAIRD C. BRITTINGHAM
5809 KENNETT PIKE
CENTERVILLE
WILMINGTON, DE 19807

R. NED NELSEN, ESQ.
EXECUTOR
ESTATE OF ELINOR M. BRYDEN
3910 OAKWOOD AVENUE
LOS ANGELES, CA 90004

VIOA G. EVANS 955 BIENVENEDA PACIFIC PALISADES, CA 90272	and w/Warranty as Trustee of BARTON EVANS TESTAMENTARY TRUST
ROBERT W. GOODFADER 800 PACIFIC AVENUE VENICE, CA 90291	
HILLARD W. GORDON 10348 STAFFORD LANE CHATSWORTH, CA 91311	
JUDITH L. HOLDEN 12404 RIDGE ROAD LOS ANGELES, CA 90049	
JAMES McHUGH 401 SO. BURNSIDE AVE., #12H LOS ANGELES, CA 90036	
OSCAR PARNESS 16588 CALNEVA DRIVE ENCINO, CA 91436	
RICHARD PARNESS 1729 CRISLER WAY LOS ANGELES, CA 90069	
LOIS C. SAFFIAN 5680 HILL OAK DRIVE LOS ANGELES, CA 90069	w/Warranty as Trustee of MORRIS SAFFIAN TES- TAMENTARY TRUST
ROBERT SAFFIAN, M.D. 15546 MEADOWGATE ENCINO, CA 91436	
JOHN T. McCARTHY 111 EAST KELLOGG BLVD., #2911 ST. PAUL, MN 55101	(FOR INFORMATION ONLY)

RICHARD M. HYDE
POST OFFICE BOX 153
NORTHRIDGE, CA 91328

(FOR INFORMATION ONLY)

APPENDIX G

S 109 242

IN THE
Supreme Court of California

In the Matter of CHARLES CONNELL McCARTHY, No. 20803 A Member of the State Bar	**Case No.: S 109 242** **State Bar Case No. 96-O-00528**

After a Decision by the
Review Department of the State Bar Court

REPLY TO BRIEF IN OPPOSITION TO VERIFIED PETITION FOR WRIT OF REVIEW

* * *

[1] TO THE HONORABLE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF CALIFORNIA:

Pursuant to California Rules of Court, Rule 952(a), Petitioner, CHARLES CONNELL McCARTHY ("Petitioner" or "McCarthy"), respectfully submits his Reply to the unverified Brief in Opposition to the Verified Petition for Writ of Review.

[2] INTRODUCTION

Nothing in the State Bar's Opposition[1] should persuade this Court not to grant the instant Verified Petition for Writ of Review. Indeed, the Opposition all but admits that Petitioner did not receive a fair trial or appeal and that his case should be reviewed by this Court.

STATEMENT OF FACTS

Petitioner respectfully requests that this Court disregard the State Bar's recitation of Facts in its entirety for failure to cite to any portion of the record. The State Bar has instead cited only to the conclusions set forth in the Review Department Opinion, which itself also does not reference any portion of the record.

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[1] California Rules of Court, Rule 952(a) permits the filing of an "Answer;" however, the State Bar's general counsel has filed a document entitled "Brief for Respondent State Bar of California in Opposition to Petition for Review." Although the Petition for Writ of Review is verified under penalty of perjury, the State Bar's "Opposition" is not, in violation of Code of Civil Procedure Section 446(a), which provides that where an initial pleading is verified, "the answer ***shall*** be verified." (Emphasis added)

[3] LEGAL DISCUSSION

I

THE FACTUAL PREDICATE FOR THE MORAL TURPITUDE CHARGE WAS NOT ALLEGED IN THE NOTICE OF DISCIPLINARY CHARGES, WAS NOT DISCLOSED IN DISCOVERY, WAS NOT LITIGATED AT TRIAL, AND WAS RAISED FOR THE FIRST TIME ON APPEAL

In conduct that is hardly becoming "an arm of this Court,"[2] the State Bar's general counsel makes the shamelessly inaccurate argument that "Petitioner claims that the Notice of Disciplinary Charges ("NDC") did not adequately advise him of the factual basis for the charges against him because it alleged 'dishonest' conduct instead of 'breach of fiduciary duty.'" (Opposition, p. 4.)

Although the State Bar accurately recites that NDC only alleged 'dishonest' conduct instead of 'breach of fiduciary duty,'" that is ***not*** the basis of the argument raised in the Verified Petition. Rather, the gravamen of Petitioner's argument is this: the factual predicate that purportedly supports the moral turpitude charge – Petitioner's receiving his own share of the Kau partnership distribution (*see* Verified Petition, p. 20; Rev. Dept. Opin. p. 15) – was not alleged in the NDC, was not disclosed in the discovery responses provided by the State Bar's Office of Chief Trial [4] Counsel ("OCTC") (*see* Verified Petition, p. 18, n.7), was not litigated at any time during trial, and

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[2] "[I]n matters of discipline and disbarment, the State Bar [Court] is but an arm of this court. . . ." (*In re Rose* (2000) 22 Cal.4th 430, 439.)

was raised for the first time on appeal by the Review Department.

The State Bar admits, as it must, that an attorney charged in a disciplinary proceeding must be "***fairly*** apprised of the ***precise*** nature of the charges before the proceedings commence." (Opposition, p. 4, quoting *Van Sloten v. State Bar* (1989) 48 Cal.3d 921, 929 (emphasis added).) However, the State Bar then erroneously maintains that a "bare allegation of misappropriation" (Opposition, p. 5) was constitutionally adequate and cites the case of *Baker v. State Bar* (1989) 49 Cal.3d 804 in support. However, nowhere in the *Baker* opinion is there any approval of merely a "bare allegation of misappropriation." To the contrary, *Baker* specifically requires more:

> The stipulated facts do not establish a violation of . . . section [6106] as to [3 of 10 counts] however. Once again we are constrained to call to the attention of the State Bar Court the importance of ***identifying with specificity*** both the rule or statutory provision that underlies each charge and ***the manner in which the conduct allegedly violated that rule or statutory provision***. . . . This specificity is also ***essential to meaningful review*** of the recommendation of the State Bar Court. (*Baker v. State Bar* (1990) 49 Cal.3d 804, 816 (emphasis added).)

Indeed, the State Bar's Opposition amply demonstrates the necessity of specific allegations in the NDC. The State Bar's general counsel argues that moral turpitude may be premised on "misappropriation of ***another***'s property." (Opposition, p. 6, quoting *Baker*, 49 Cal.3d at 815 (emphasis added), while acknowledging that Petitioner was only "charged with misappropriation of

Ashjian's funds." (Opposition, p. 7.) However, the Review Department makes clear that the alleged misappropriation of [5] ***Ashjian***'s funds is ***not*** the factual predicate for the moral turpitude charge: "[W]e ***need not and do not decide whether the funds which respondent took belonged to Ashjian or to Kau***. . . ." (Rev. Dept. Opin. p. 15 (emphasis added).) Thus, the State Bar has proven Petitioner's point: the moral turpitude charge is unconstitutionally based on unalleged, undisclosed, and unproven "facts" that were not raised by the State Bar until the Review Department Opinion.

The Opposition also argues that a showing of specific prejudice is required and cites as support the cases of *Morales v. State Bar* (1988) 44 Cal.3d 1037, 1047 and *Stuart v. State Bar* (1985) 40 Cal.3d 838, 845, neither one of which involved a defective NDC that "did not lay out enough factual detail," as does this case. (Opposition, p. 5.) This contention is absurd. Although Petitioner raised the issue of the NDC's inadequacies in a pretrial Motion to Dismiss, as set forth in the Verified Petition, the Hearing department went beyond the four corners of the NDC to deny such motion. (*see* Verified Petition, pp. 24-25.) Thereafter, Petitioner was forced to incur the time and expense of retaining counsel, standing trial, prosecuting an appeal to the Review Department, and pursuing this Verified Petition – all as a result of the unalleged, undisclosed, and unproven conduct. Petitioner respectfully submits that these burdens are more than enough to be considered prejudice.

Accordingly, it is respectfully submitted that this Court grant review and determine that the NDC was constitutionally inadequate.

[6] II

THE PERIOD OF LIMITATIONS IS UNCONSTITUTIONAL

The State Bar's Opposition ignores the Petition's constitutional arguments and simply argues that the provision tolling the Period of Limitations during the period of time where the Petitioner purportedly "conceals facts constituting the violation" operated to permit the NDC to be field in November 1999, well beyond the five-year period mandated by Rule 51 of the Rules of Procedure of the State Bar of California. (Opposition, p. 6-8.)

As set forth in greater detail in the Verified Petition, the State Bar's stated basis for denying Petitioner's motion to dismiss (brought on the grounds that the Period of Limitations had expired) was the unalleged notion that the obligation to hold "monies in trust" was a "continuing wrong" that persisted until at least 1996 and the Period of Limitations was thus tolled (*see* Verified Petition, pp. 24-25). Following the Culpability Ruling, the Hearing department changed its mind and ruled instead that the Period of Limitations was tolled via the "concealment" provision (*see* Verified Petition, pp. 25-27). On appeal, in the face of Petitioner's compelling arguments that there had been no misappropriation, the Review Department for the first time changed the factual predicate underlying the moral turpitude charge from "misappropriation of Ashjian's funds" to the unalleged act of simply receiving Petitioner's own distribution.

This judicial sleight of hand, while purporting to preserve the Hearing Department's finding of culpability, rendered the State Bar's application of the Rule of Limitations unconstitutional as applied to [7] Petitioner. Had the

NDC properly alleged that it was the receipt of his own final distribution that was in issue – a one-time occurrence which the Review Department found took place in March 1993 (Rev. Dept. Opin. p. 7) – the Hearing Department could not have denied Petitioner's Motion to Dismiss on the grounds that there was a "continuing wrong." Thus, after alleging one thing ("misappropriation of Ashjian's funds") in the NDC and surviving the Motion to Dismiss, the State Bar then changed the factual predicate on appeal (to "receiving his own final distribution"), apparently after realizing that there were no facts and/or law to support the original allegation.

In so doing, the State Bar has painted itself into a proverbial corner: the purported concealment of the purported "misappropriation of Ashjian's funds" can no longer save the untimeliness of the NDC. Instead, any evidence of "concealment" would have to focus on the new factual predicate: the receipt of Petitioner's own final distribution. In this case, however, there are no allegations no evidence, and no findings by either the Hearing Department or the Review Department that Petitioner ever concealed or even did anything to try to conceal his receipt of his own final distribution. Accordingly, the Period of Limitations necessarily began to run in March 1993 (and was not tolled under the "continuing wrong" provision, the "concealment" provision, or any other provision in Rule 51) and had expired before the NDC as field in November 1999.

The State Bar's assertion that "Ashjian did not know his funds were gone until 1996" is irrelevant. As set forth in greater detail in the Verified Petition (pp. 25-27), the Period of Limitations began to run in 1988, when Ashjian first suspected the Petitioner had purportedly "done

something [8] wrong to him" (*see Norgart v. Upjohn Co.* (1999) 21 Cal.4th 383, 397-98) and Ashjian retained counsel at a major law firm to protect his interests. (Rev. Dept. Opin., 3:12-13; Ex. BBBB.) Moreover, based on the Review Department's new version of the facts, it was Petitioner's receipt of his own final distribution and not the loss of "Ashjian's funds" that is the operative event for determining the beginning of the Period of Limitations.

Finally, although there is no provision in Rule 51 that permits a late field NDC if there is no prejudice, the State Bar's Opposition contends there was no prejudice other than the Hearing Department's refusal to permit Petitioner to call a key witness via telephone who was retired and unavailable to attend the hearing due to his aging wife's hospitalization or the fact that Petitioner should be spending his 'golden years' with his grandchildren. To the the [sic] contrary, as a direct result of the State Bar's flipflopping of facts to avoid the bar of the Rule of Limitations, Petitioner was forced to incur the time and expense of retaining counsel, standing trial, prosecuting an appeal to the Review Department, and pursuing this Verified Petition. Petitioner respectfully submits that these burdens are more than enough to be considered prejudice.

III

PETITIONER PROPERLY RELIED ON THE ADVICE OF HIS COUNSEL, WHO ALONE NEGOTIATED THE FAILED SETTLEMENT ALLEGED TO VIOLATE BUSINESS & PROFESSIONS CODE § 6090.5

[9] As to Count Two, the State Bar's Opposition does not dispute that a principal cannot ratify the transaction

of an agent unless the principal has voluntarily accepted the benefit of such transaction and had "full knowledge of the material facts" regarding such transaction. (2 Witkin, SUMMARY OF CAL.LAW (9th Ed. 1987 and 1999 Supp.) *Agency and Employment* § 89, p. 89.) The State bar's Opposition does not dispute that Petitioner was unaware of the provisions of Business and Professions Code Section 6090.5(a)(2) prohibiting the withdrawal of a complaint to the State Bar as part of any settlement agreement or even negotiating such withdrawal. The State Bar's Opposition does not dispute that "an act wholly void for illegality cannot be ratified." (*Id.* at § 91 (*citing Bear River Sand & Gravel Corp. v. Placer* (1953) 118 Cal.App.2d 684, 689).)

Instead, the State Bar's Opposition argues that Petitioner's professional responsibilities (though not specified, presumably the State Bar is referring to knowledge of the provisions of Section 6090.5) are non-delegable and cites as its sole support of such proposition Civil Code Section 3519, which in turn provides in its entirety: "He who can and does not forbid that which is done on his behalf, is deemed to have bidden it." Section 3519 is silent as to whether professional responsibilities can or cannot be delegated.

However, the Civil Code also provides an equally applicable "maxim of jurisprudence:" "no one should suffer by the act of another." (*Civil Code* § 3520.) Moreover, in *Kaplan v. State Bar* (1991) 52 Cal.3d 1067, this Court affirmed the Hearing department's finding that there was no moral turpitude in connection with Attorney Kaplan's withdrawal of certain trust account funds:

> [10] Because this was a bankruptcy matter, however, Kaplan did not realize that he could not withdraw the funds without prior court approval.

> Further, an experienced bankruptcy attorney had indicated to Kaplan that the funds were available for withdrawal. (*Kaplan*, 52 Cal.3d at 1070 n.3.)

Thus, this Court has acknowledged that ignorance of the law, coupled with reliance on counsel, can indeed be a defense in State Bar disciplinary proceedings. Moreover, in this case, Petitioner has indeed been forced to suffer as a consequence of the actions taken by James Felton and the law firm of Greenberg & Bass, who were retained by Petitioner as counsel to represent him in connection with his dispute with Ashjian and in connection with the instant State Bar proceeding. By negotiating a settlement with Ashjian that purportedly included the withdrawal of his State Bar complaint and by failing to inform Petitioner of the impropriety of doing so, Petitioner's counsel[3] has been subjected to the instant disciplinary proceeding.

[11] **IV**

THIS MATTER SHOULD BE STAYED PENDING THE OUTCOME OF *CANATELLA v. CALIFORNIA*

The State Bar's Opposition argues that this case should not be stayed pending the outcome of the pending

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[3] The OCTC listed Felton on its witness list but did not call him at the time of trial. Thus, there was no evidence adduced that Felton had provided Petitioner with "full knowledge of the material facts" regarding the proposed settlement with Ashjian. Accordingly, there are insufficient facts to support a finding that Petitioner "ratified" Felton's proposed settlement agreement.

federal action entitled *Canatella v. State Bar*,[4] [sic] on the grounds that "'[O]ne to whose conduct a statute clearly applies may not successfully challenge it for vagueness.'" (Opposition, p. 9.)

The State Bar apparently misunderstands Petitioner's request. There is nothing in the Verified Petition that argues that Section 6106 is unconstitutional as applied to a charge of misappropriation. Petitioner has instead raised constitutional challenges to the charges that were alleged (or more accurately, not alleged) in the NDC and the application of the Period of Limitations. With respect to *Canatella*, Petitioner is simply pointing out that there is a pending federal case in which a federal court could potentially rule that Section 6106 is constitutionally invalid on its face based on the First and Fourteenth Amendments to the United States Constitution. In that event, Petitioner has noted that many of the issues raised in this Verified Petition relating to the moral turpitude charge could well be rendered moot. Accordingly, a stay of this action pending the final outcome in *Canatella* may well be prudent at this time.

[12] CONCLUSION

For each of the foregoing reasons, Petitioner, CHARLES CONNELL McCARTHY, respectfully requests that this Court issue a writ of review to: 1) determine the

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[4] Presumably, the State Bar's Opposition is referring to the case of *Canatella v. California*, 2002 U.S. App. LEXIS 18468, which has been remanded to the United States District Court for a trial on issues *inter alia* whether Business and Professions Code Section 6106 is unconstitutionally vague and/or overbroad on its face.

propriety of identifying the purported factual basis for a "moral turpitude" disciplinary charge for the first time on appeal; 2) determine the constitutionality of the "Period of Limitations" set forth in Rule 51 of the State Bar Rules of Procedures; and 3) determine whether a party may "ratify" an agreement reached solely through his counsel without ever having "full knowledge of the material facts." Alternatively, Petitioner requests that this matter be stayed pending the issue of a final decision in the pending federal action entitled *Canatella v. California*.

DATED: November 14, 2002.

Respectfully submitted,
PRINCE & HEUER
A Professional Law Corporation

By: /s/ Henry T. Heuer
HENRY T. HEUER
Attorneys for Petitioner,
CHARLES CONNELL
McCARTHY.

* * *

APPENDIX H

United States Court of Appeal Docket No. 02-56824
Lower Court Docket No. CV-02-03588-JFW
Bankruptcy Court Case No. SV-96-15656-AG
Adversary No. AD-96-01550-AG

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In re: CHARLES C. McCARTHY,

Debtor

CHARLES C. McCARTHY, et al.,

Defendant and Appellant.

vs.

NAZAR H. ASHJIAN, JR., et al.,

Plaintiff and Appellee,

On Appeal from the United States District Court
for the Central District of California
Honorable John F. Walter

[United States Bankruptcy Court
for the Central District of California –
San Fernando Valley
Honorable Arthur M. Greenwald]

APPELLANT'S OPENING BRIEF

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[1] STATEMENT OF JURISDICTION

A. Subject Matter Jurisdiction of Bankruptcy Court.

This appeal arises from an adversary proceeding, Case No. [] AV 96-01550, originally before the United States Bankruptcy Court for the Central District of California, which had subject matter jurisdiction under 28 U.S.C. § 1334 in that this proceeding arose in a case under Title 11, the claims asserted herein arose under Title 11, and this action is related to a case filed pursuant to Title 11, *In re Charles C. McCarthy*, Case No. SV 96-15656-AG, a Chapter 7 case pending in the same bankruptcy court.

B. Basis of the Court of Appeal's Jurisdiction.

This appeal was previously before the United States District Court for the Central District of California pursuant to its appellate authority in bankruptcy matters, as set forth in 28 U.S.C. § 158(a)(1). Following the district court's final order affirming the bankruptcy court judgment, this Court has subject matter jurisdiction pursuant to 28 U.S.C. § 158(d).

C. Timeliness of this Appeal.

The district court's final order affirming the bankruptcy court judgment was filed on September 25, 2002. Pursuant to Rule 4(a) of the Federal Rules of Appellate Procedure, the Notice of Appeal in this case was timely filed on October 25, 2002.

D. This is an Appeal from a Final Order.

The district court's order dated September 25, 2002 affirmed the underlying bankruptcy court judgment in its entirety.

[2] The underlying bankruptcy court judgment (ER 00714)[1] had disposed of all the parties' claims.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

This appeal presents the following single issue, which this Court should resolve in favor of McCarthy:

1. Did the Bankruptcy Court commit reversible error when, on July 25, 1997, it entered an order awarding Partial Summary Judgment in favor of Ashjian and against McCarthy based solely on the doctrine of collateral estoppel thereby giving preclusive effect to a prior state court-ordered arbitration award? Because California law does not permit courts to give preclusive effect to a judicial arbitration award (even if reduced to final judgment) and because the issue of "breach of fiduciary duty" was not even alleged, let alone "necessarily decided" or "essential to the judgment," McCarthy respectfully submits that this Court will also be compelled to answer this question in the affirmative.

This Court reviews the appellate decision of a district court in a bankruptcy proceeding under a *de novo*

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[1] "ER ___" refers to the Excerpts of Record (and page number therein) prepared and filed by Appellant, McCarthy.

standard of review. (*Bonner Mall Partnership v. U.S. Bancorp Mortgage Co. (In re Bonner Mall Partnership)*, 2 F.3d 899, 903 (9th Cir. 1993); *see also United States IRS v. Palmer (In re Palmer)*, 207 F.3d 566, 567 (9th Cir. 2000) (review of BAP decision).) As this Court explained in *Sousa v. Miguel (In re United States Trustee)*, 32 F.3d 1370 (9th Cir. 1994):

> 'We are in as good a position to review the bankruptcy court's decision as is the district court. Thus, when we review a district court decision with respect to a final order of a bankruptcy court, [3] we in essence are reviewing the final order of the bankruptcy court.' [citation omitted] 'We apply the same standard of review to the bankruptcy court findings as does the district court: findings of fact are reviewed under the clearly erroneous standard, and conclusions of law, *de novo*.' [citations omitted] (*Sousa*, 32 F.3d at 1372.)

This Court reviews the bankruptcy court's granting of summary judgment under a *de novo* standard of review. (*In re United Energy Corp.*, 944 F.2d 589, 593 (9th Cir. 1991).) In reviewing the granting of partial summary judgment in favor of Ashjian, this Court's "task is identical to that of the trial court." (*M/V American Queen v. San Diego Marine Constr. Corp.*, 708 F.2d 1483, 1487 (9th Cir. 1983).) This Court should "view the evidence in the light most favorable to the party ***against*** whom the summary judgment is granted," and "determine *de novo* whether there was no genuine issue of material fact" (*Id.* (emphasis added)) and "whether the [trial] court correctly applied the relevant substantive law." (*Franklin Financial v. Resolution Trust Corp.*, 53 F.3d 268, 271 (9th Cir. 1995); *see also*

Cairns v. Franklin Mint Co., 2002 U.S. App. LEXIS 12032 (9th Cir. 2002).)

The "application" of collateral estoppel is reviewed on a *de novo* standard of review. (*Palmer*, 207 F.3d at 567.)

STATEMENT OF THE CASE

1. Nature of the Case

This case involves a Chapter 7 adversary proceeding in which the bankruptcy court granted partial summary judgment in favor of Ashjian and thus determined that an alleged debt owed by McCarthy to Ashjian was nondischargeable under 11 U.S.C. § 523(a)(4).

[4] 2. Course of Proceedings and Disposition

On May 13, 1994, Ashjian commenced a lawsuit against McCarthy by filing his "Complaint for Breach of Contract; Common Counts"[2] in Los Angeles County Municipal Court, Case No. 94E04139 (the "Municipal Court action"). (ER 00001-00007.)

Each of the causes of action in Ashjian's complaint was based on a contract-type claim for a sum certain. There were no claims for "breach of fiduciary duty" or any other torts.

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[2] The state law "common counts" were as follows: 1) Money Had and Received (ER 00004); 2) Account Stated (00004); and 3) Open Book Account (ER 00005).

Pursuant to California Code of Civil Procedure Section 1141.10 *et seq.*, the matter proceeded to judicial arbitration, which resulted in a November 17, 1995 award of $31,606.22 in favor of Ashjian and against McCarthy. (ER 00011.) Because McCarthy was about to file for bankruptcy protection, he did not request a trial *de novo* (the mechanism under which a litigant in his position could "appeal" the award; *see Cal. Code of Civil Procedure* § 1141.20), in anticipation that this alleged "breach of contract" debt would be discharged.

McCarthy filed a petition for relief under Chapter 7 of the Bankruptcy Code on May 21, 1996. (*In re Charles C. McCarthy*, Case No. SV 96-15656-AG.)

Ashjian filed his Adversary Complaint to Determine Dischargeability on August 22, 1996 (*Ashjian v. McCarthy*, Adversary Proceeding No. AV 96-01550-AG). (ER 00014-17.) Ashjian sought to determine the non-dischargeability of the following alleged ***debts*** that totaled approximately $54,000.00: 1) an alleged debt in the amount of $27,493.22 ($31,606.22 less $4,113.00 that Ashjian collected) as a result of the aforementioned Municipal Court action (Ashjian's "First Claim"); [5] 2) an alleged debt in the amount of $1,312.00 (Ashjian's "Second Claim") and 3) an alleged debt in the amount of $25,324.00 (Ashjian's "Third Claim"). (ER 00017, 00453.)

On May 13, 1997, Ashjian prepared, and the bankruptcy court signed, its Joint Pretrial Order, which provides in relevant part as follows:

> The following ***issues of fact***, and no others, remain to be litigated; provided, however, that by ***agreeing that the following issues are disputed***, no admission is made by either party as

> to the relevance of such facts: 1. Debtor [McCarthy], as the fiduciary of the funds in Kau-Kona, ***breached his fiduciary duty***. . . . (ER 00119 (emphasis added).)

Ashjian brought a Motion for Summary Judgment (ER 00136) that was heard on July 23, 1997 in the bankruptcy court. The Court granted Partial Summary Judgment as to Ashjian's First Claim on the grounds that the doctrine of collateral estoppel and the prior Municipal Court judgment applied to bar relitigation of the issue of whether McCarthy's conduct "constitutes a defalcation within the meaning of [11 U.S.C.] Section 523(a)(4)."[3] (ER 00458 (Memorandum of Decision re Summary Judgment, 7:23-25).) The Court denied Summary Judgment as to Ashjian's Second Claim (which the Court found to be barred under the doctrine of claim preclusion) and as to Ashjian's Third Claim. (ER 00455-00456.)

Trial as to Ashjian's Third Claim began on February 2, 1998 and continued through February 3, 1998, with McCarthy prevailing. The bankruptcy court instructed James Felton, McCarthy's counsel at the time, to prepare proposed [6] Findings of Fact and Conclusions of Law and a proposed Judgment as to the entire case. (ER 01033-01034 (February 3, 1998 transcript, 2-68-2-69).) Attorney Felton did not submit these documents. (ER 00463-00464.) Thereafter, neither Ashjian nor his counsel (despite having the right, ability, and the motivation to do so) took any steps to prepare either of these documents (ER 00616)

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[3] That statute precludes an individual debtor from discharging any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." (11 U.S.C. § 523(a)(4).)

and the matter languished dormant on the bankruptcy court docket for years.

In approximately February 2001 (some three years after trial), Ashjian attempted to notice a "judgment debtor exam" of McCarthy (*see* ER 00567-00568, 00570-00575) and then proceeded to "execute" on the non-existent judgment by levying on bank accounts held by McCarthy and his wife (ER 00513-00517). McCarthy's counsel wrote to Ashjian's counsel on multiple occasions and explained in great detail that this course of conduct was improper in light of the absence of entry of any judgment. (ER 00567-00568, 00570-00575.)

On February 6, 2002, the bankruptcy court entered judgment in favor of Ashjian and against McCarthy as to Ashjian's First Claim and in favor of McCarthy and against Ashjian as to Ashjian's Second Claim and Third Claim. (ER 00714.) McCarthy appealed the matter to the United States District Court (ER 00718), which summarily affirmed the bankruptcy court judgment in its entirety without considering oral argument or rendering an opinion.

3. Statement of Facts

According to the bankruptcy court, McCarthy is a "lawyer of some reputation." (ER 00796 (1-19:3).) To describe in full detail how McCarthy came to be before this Court could easily exhaust the page limitation for this entire brief. Instead, the following statement of facts includes only as much background as is necessary.

[7] The genesis of this lawsuit was the creation by McCarthy on October 10, 1967 of a California limited

partnership named the Kau-Kona Land Company ("Kau").[4] (ER 00233.) Kau, along with Pua and Ono, each purchased a large parcel of then-unimproved prime real estate on the Kona Coast of the Big Island of Hawaii and held a combined 1,878 acres at a collective purchase price of $4.1 million. (ER 00267, 00299.) Kau itself held approximately 1,400 acres of prime land located five miles north of Kona at a purchase price of $1.4 million (*i.e.*, $1,000.00 per acre). (ER 00243.) Kau acquired this real estate under very favorable terms: payment of two years of prepaid interest was all that was required to close escrow, and Kau only had to pay one year prepaid interest for each of the next five years. (ER 00243.) It was the intent of each of these limited partnerships, including Kau, to hold these parcels for resale at a profit; thus allowing the limited partners to take advantage of the then-favorable tax treatment of capital gains. (ER 00233-00234.) McCarthy drafted the Kau limited partnership agreement and was one of its two general partners, as well as a 5% limited partner investor.[5] (ER 00233.) Ashjian was a 1% limited partner investor in Kau (one of 23 of Kau's regular limited partners), having originally contributed $3,000.00 and holding a 0.6% interest in profits. (ER 00223, 00240.)

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[4] By way of background, McCarthy also created two other California limited partnership, the Puapua-Kona Land Company ("Pua") and the Onouli-Kona Land Company ("Ono"), at approximately the same time, but neither of these limited partnership is relevant to these proceedings. McCarthy prevailed at trial on Ashjian's claims as to Pua, and Ashjian did not appeal.

[5] As of September 1983, McCarthy was Kau's sole general partner. (ER 00245.)

[8] In 1971, the state of Hawaii instituted eminent domain proceedings as to approximately 400 acres of Kau's real estate holdings, which Kau settled, under McCarthy's direction, for $1.65 million ($4,125.00 per acre). (ER 00243.) Kau was then able to pay off the purchase note in its entirety, and thus held the remaining approximately 1000 acres "free and clear." Kau distributed virtually the entire balance of the settlement monies to Kau's limited partners, who collectively recouped approximately $300,000.00 of their $700,000.00 initial tax deductible capital contributions. (ER 00243.)

Thereafter, because the tax benefits associated with prepaid interest began to be phased out in the 1970's, McCarthy aggressively marketed the remaining 1000 acres of Kau's real property for sale to investors from Japan and Europe. (ER 00244.) For a variety of reasons beyond McCarthy's control, such as the Arab-Israeli War, these efforts ultimately proved unsuccessful. (ER 00244.) When it could not be sold, Kau instead focused its efforts on developing the property itself, including the "absolutely essential" (without water, development would be impossible) acquisition of 900 "water units" (*i.e.*, a "reservation" for not-yet-available water in future developments)[6] and the successful re-zoning of approximately 732 acres from

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[6] In order to acquire these "water units," Kau borrowed $300,000.00 from Sterling Bank of Los Angeles, which was secured by the real property and personally guaranteed by McCarthy. (ER 00246.) The sale of water units was administered by the Hawaii County Water Department and was originally to have been developed in conjunction with the issuance of long-term municipal bonds. (ER 00246.)

five-acre lots to three acre lots.[7] (ER 00245-00246.) In approximately 1980, because of his dedication to his duties as Kau's general [9] partner, McCarthy gave up what had been a thriving law practice. In 1984, the County Water Department abandoned its plan to bond the funding of water facilities improvements and instead required Kau to pay an additional $1,500.00 *per unit* (*i.e.*, $1,350,000.00) by July 1986. (ER 00246.) In 1986, Kau filed for Chapter 11 bankruptcy to prevent the forfeiture of its water rights to Hawaii County and to stay foreclosure of its land for non-repayment of the $300,000.00 land loan that McCarthy had personally guaranteed. (ER 00246.)

In the fall of 1987, Kau obtained a loan commitment from CitiSavings & Loan of San Antonio, Texas ("CitiSavings") to finance the purchase of Kau's real property out of bankruptcy prior to December 31, 1987. (ER 00246-00247.) Although time was "of the essence," CitiSavings breached its loan commitment, leaving McCarthy to search for an alternative disposition of Kau's real property as soon as possible. (ER 00247.) In or about May 1988, McCarthy was able to find a buyer for Kau's land, who paid $5,250,000.00 cash.[8] (ER 00248.) The bankruptcy court approved this sale, along with McCarthy's plan for disbursing the sale proceeds and the dismissal of Kau from bankruptcy. (ER 00247, 00329, 00348.)

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[7] Following this re-zoning, in 1983, Kau's remaining parcel of real estate was appraised at $12,500,000.00. (ER 00246.)

[8] Nine months later, the real property formerly owned by Kau was re-sold for $13,500,000.00. (ER 00249.)

On or about July 27, 1988, McCarthy sent a five-page letter (plus enclosures) to all the Kau limited partners detailing the sale of the property and corresponding bankruptcy court activity, and explaining how the sale proceeds would be disbursed. (ER 00248, 00352-00365.) In light of various claims and objections by a small minority of the limited partners, McCarthy asked that each limited partner either sign a "Warranty, Indemnification, and Release re Preliminary Distribution of Profits" (ER 00365) or inform McCarthy of any [10] specific claims against him as Kau's general partner or the Kau itself. (ER 00248, 00352-00356.) Virtually all the Kau limited partners signed the release and received their distributions. (ER 00248.) Ashjian, along with the Estate of Elinor Mayer Bryden, did not. (ER 00124, 00248.) Almost immediately thereafter, Bryden's estate commenced litigation. (ER 00248-00249.) On July 11, 1989, this litigation concluded with the Los Angeles Superior Court ***ordering Bryden's representative to sign the release document.*** (ER 00249, 00375-00376.) Meanwhile, Ashjian filed his lawsuit in Los Angeles Municipal Court (ER 00001), with the volunteer arbitrator there reaching a different result as to the propriety of this release document than the Superior Court judge in the *Bryden* litigation.

In 1989, Kau was a named plaintiff in a lawsuit filed against CitiSavings and its attorneys for breach of its loan commitment. (ER 00249.) The lawsuit sought damages for loss of development profits in the amount of $63 million or alternatively damages in the amount of $8 million, (*i.e.*, the difference between the 1988 sale price of $5,250,000.00 and the sale price nine months later of $13,500,000.00), plus an award of punitive damages. (ER 00249.) In November 1990, two months into trial, the Resolution Trust

Corporation took over CitiSavings and Kau's lawsuit was dismissed as required by law.[9] (ER 00249-00250.)

After arrangements with at least two potential buyers of the Kau property fell through, McCarthy in May 1996 filed the instant Chapter 7 bankruptcy. (ER 00250.) Therefore, Kau was dissolved pursuant to Article XIII B of the Kau Limited Partnership Agreement, the capital accounts of each of the Kau limited partners had no value thereafter, and any prior positive value was shown as an [11] ordinary loss on each limited partners' K-1 statement for 1996. (ER 00250.)

Thereafter, Ashjian filed his Municipal Court complaint, followed by the underlying adversary proceeding. (ER 00250.)

[12] SUMMARY OF ARGUMENT

The bankruptcy court, the Honorable Arthur M. Greenwald presiding, committed reversible error when, on July 25, 1997, it entered an order awarding Partial Summary Judgment in favor of Ashjian and against McCarthy based solely on the doctrine of collateral estoppel – thereby improperly giving preclusive effect to a prior state court-ordered arbitration award. Because California law does not permit courts to give preclusive effect to a judicial arbitration award (even if reduced to final judgment) and because the issue of "breach of fiduciary duty" was not even alleged, let alone "necessarily decided" or "essential

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[9] Kau's lawsuit against CitiSavings' *attorneys* continued however and eventually settled for $1 million. (ER 00250.)

to the judgment," the bankruptcy court could not and should not have granted partial summary judgment in Ashjian's favor. McCarthy is entitled to a trial as to Ashjian's First Claim.

[12] LEGAL ARGUMENT

1. The Bankruptcy Court Committed Reversible Error When It Entered an Order Awarding Partial Summary Judgment in Favor of Ashjian and Against McCarthy.

A. Requirements for Application of Collateral Estoppel.

"Collateral estoppel bars relitigation of issues actually adjudicated and ***essential to the judgment*** in earlier litigation between the same parties." (*Garrett v. City and County of San Francisco*, 818 F.2d 1515, 1520 (9th Cir. 1987) (emphasis added).) However, "redetermination of issues is warranted if there is reason to doubt the quality, extensiveness, or fairness of procedures followed in prior litigation." (*Kremer v. Chemical Constr. Co.*, 456 U.S. 461, 481 (1982).) McCarthy acknowledges that as a general rule, "collateral estoppel applies in dischargeability proceedings." (*Bugna v. McArthur (In re Bugna)*, 33 F.3d 1054, 1056 (9th Cir. 1994).) "In determining the collateral estoppel effect of a state court [13] judgment, federal courts must, as a matter of full faith and credit, apply that state's law of collateral estoppel." (*Bugna*, 33 F.3d at 1057, citing *inter alia* 28 U.S.C. § 1738 and *Kremer*, 456 U.S. at 481-82; *Diamond v. Kolcum (In re Diamond)*, 285 F.3d 822, 826 (9th Cir. 2002).) "Accordingly, the collateral estoppel effect of the state court determination . . . here is governed by California law." (*Bugna*, 33 F.3d at 1057.) The United States Constitution requires that California

> must, however, satisfy the applicable requirements of the Due Process Clause. A State may not grant preclusive effect in its own courts to a constitutionally infirm judgment and other state and federal courts are not required to accord full faith and credit to such a judgment. (*Kremer*, 456 U.S. at 482.)

As set forth in greater detail below, under California law, the doctrine of collateral estoppel does not apply to judicial arbitration awards (even if eventually reduced to final judgment) such as the one that formed the basis for the bankruptcy court's erroneous granting of partial summary judgment below. However, even if the doctrine *did* apply to judicial arbitration awards, the granting of partial of summary judgment should still be reversed because the underlying arbitration award fails to meet all the requirements necessary to apply collateral estoppel, as set forth by the California Supreme Court. Finally, even if collateral estoppel did establish a breach of fiduciary duty, partial summary judgment was still inappropriate in light of Ashjian's failure to establish that McCarthy's conduct caused his loss.

[14]

B. <u>Under California Law, the Doctrine of Collateral Estoppel is Inapplicable to Judicial Arbitration Awards</u>.

Under California law regarding collateral estoppel, if the prior proceeding is a judicial arbitration that does not state the same cause of action as the subsequent proceeding, the doctrine of collateral estoppel does not apply, even if the arbitration award eventually becomes a "final" court judgment:

> It would be ***unfair and unwise to give collateral estoppel effect to judicially arbitrated resolutions of issues***. . . . No record is made of arbitration proceedings and generally no findings of fact or conclusions of law are required. [citation omitted] Thus it is difficult to determine from the award alone what issues were actually litigated and how they were resolved. [¶] Even if this difficulty could be surmounted, ***it is unfair to bind the parties to judicially arbitrated resolution of issues***. The doctrine of collateral estoppel is based on the premise that a thorough fact-finding process was completed in the first proceeding. [citation omitted] However, in judicial arbitration, the low monetary amount in controversy and the option of trial de novo can leave parties ***without a serious incentive to litigate***. Because the stakes involved are low, the parties may be willing to accept a compromise position without much of a fight. [citation omitted] [¶] Moreover, it is ***unlikely parties would expect a judicial arbitration award to have collateral estoppel effect in other proceedings*** where the stakes may be higher than they were in the arbitration proceeding. If they did, the result might be intensified litigation, delays and costs, as well as an increased rate of trial de novo election. Such a development would be directly contrary to the purposes underlying judicial arbitration legislation. In summary, we hold that ***judicial arbitration awards*** should ***[not] be accorded . . . issue preclusion . . . effect***. (*Flynn v. Gorton*, 255 Cal.Rptr. 768, 771-72 (Cal. Ct. App. 1989) (refusing to give preclusive effect to judicial arbitration award that was reduced to final judgment and not appealed) (emphasis added).)

[15] This refusal to give preclusive effect to judicial arbitration awards is consistent with the California Supreme Court's analysis of the difference between arbitrators and judges:

> [I]t hardly requires elaboration that superior court ***judges are accountable to the public in many ways arbitrators are not***. Superior court judges are constitutional officers [citation omitted] who are sworn to uphold the United States and California Constitutions [citation omitted]. They are locally elected [citation omitted] and may be recalled [citation omitted]. They are subject to discipline by a public body, the Commission on Judicial Performance [citation omitted]. Virtually all of their proceedings take place in public view. [citation omitted]. . . . By contrast, arbitrators are not public officers and are in no way publicly accountable. Their proceedings take place in private. (*Broughton v. Cigna Healthplans of California*, 90 Cal.Rptr.2d 334, 21 Cal.4th 1066, 1091-82 (Cal. 1999).)

This case exemplifies the reasons, as set forth in *Flynn*, for why it would be unfair to apply the doctrine of collateral estoppel to judicial arbitration awards, even if such awards are eventually reduced to judgment and not appealed. Here, the volunteer arbitrator was only asked to rule on "breach of contract and common counts" and was not addressing the same cause of action that was before the bankruptcy court: whether McCarthy's debt to Ashjian was non-dischargeable due to an alleged breach of fiduciary duty. The bankruptcy court acknowledged that it did not know if there was "any basis for those findings [that McCarthy had breached his fiduciary duty and therefore committed a defalcation] in terms of whether that issue was actually litigated," (ER 00781 (1-4:4-5)) and that there

was no way to make such a determination: "Now, that raises a question of, well, how did the arbitrator come to those determinations? How would he make those findings? I don't know. There's no – I don't have a transcript." (ER 00787 (1-10:8-12).) "And I don't know what went on." (ER 00793 (1-16:21).)

[16] Judge Greenwald's on-the-record statements would thus appear to preclude any possible finding of "fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny," as required by 11 U.S.C. § 523(a)(4). Nonetheless, despite the absence of a record and the uncertainty as to whether there was any basis for the arbitrator's award, the bankruptcy court granted partial summary judgment in Ashjian's favor based solely on the Municipal Court action: "***I'm not making any independent findings. I'm making my findings exclusively based upon what the arbitrator determined*** under – applying the doctrine of collateral estoppel." (ER 00799 (1-22:1-4) (emphasis added).)

Similarly, it must be remembered that McCarthy was impecunious and on the verge of filing his Chapter 7 bankruptcy petition when he was confronted with this Municipal Code action. Because his worst-case scenario was a garden-variety contract judgment against him (that would be dischargeable in bankruptcy), McCarthy was, as *Flynn* correctly anticipated, "without a serious incentive to litigate" and therefore permitted the arbitration award to be reduced to a final judgment "without much of a fight." Moreover, McCarthy justifiably never "expect[ed] a judicial arbitration award to have collateral estoppel effect in" this proceeding, especially since the issue sought to be precluded from being relitigated, "breach of fiduciary

duty," was not even alleged in Ashjian's Municipal Court complaint.

Thus, McCarthy respectfully submits that it was prejudicially improper for the bankruptcy court to have bestowed preclusive effect on the judicial arbitration award in the Municipal Code action. (ER 00458 (Memorandum of Decision, 7:10-25).) Because the doctrine of collateral estoppel cannot, under California law, be applied to judicial arbitration awards, this Court should reverse the granting of partial summary judgment in Ashjian's favor.

[17] **C. <u>The Issue of "Defalcation" Was Neither "Essential To" Nor "Necessarily Decided" by the Arbitrator</u>.**

The California Supreme Court has set forth the following "requirements for invoking collateral estoppel:"

> (1) the issue ***necessarily*** decided in the previous proceeding is identical to the one that is sought to be relitigated; (2) the previous proceeding terminated with a final judgment on the merits; and (3) the party against whom collateral estoppel is asserted was a party to or in privity with a party in the previous proceeding. (*Coscia v. McKenna & Cuneo*, 108 Cal.Rptr.2d 471, 25 Cal.4th 1194, 1201, n.1 (Cal. 2001).)

"In order for the determination of an issue to be given preclusive effect, it must have been ***necessary to a judgment***. This requirement '***prevent[s] the incidental or collateral determination of a nonessential issue from precluding reconsideration of that issue in***

later litigation. This requirement 'is ***necessary in the name of fairness, if not due process itself*** so that parties to litigation have sufficient notice and incentive to litigate matters in earlier proceedings which may bind them in subsequent matters.'" (*McMillin Development, Inc. v. Home Buyers Warranty*, 80 Cal.Rptr.2d 611, 616 (Cal. Ct. App. 1998) (emphasis added).) "It is the burden of the person asserting collateral estoppel to prove that each of the requirements for application of the doctrine has been met." (*Rymer v. Hagler*, 260 Cal.Rptr. 76, 81-82 (Cal. Ct. App. 1989).) "If there is any doubt, collateral estoppel will not apply." (*Flynn*, 255 Cal.Rptr. at 771.)

In this case, the underlying Municipal Court action only stated causes of action for "breach of contract and common counts." (ER 00001-00005.) Neither "breach of fiduciary duty" nor "defalcation" were alleged anywhere in Ashjian's Municipal Court complaint. The absence of a "breach of fiduciary duty" or similar allegation renders the Municipal Court judgment inappropriate for collateral [18] estoppel on at least two grounds. First, the complaint states a cause of action for breach of contract and other common counts only. "'[P]roceedings ***outside the authority of the court***, or in violation or contravention of statutory prohibitions, are, whether the court have jurisdiction of the parties and subject-matter of the action or proceedings, or not, ***utterly void***.'" (*Michel v. Williams*, 56 P.2d 546, 547 (Cal. Ct. App. 1936) (emphasis added).) McCarthy received no notice whatsoever that any "breach of fiduciary duty" or "defalcation" claims were being asserted against him, thus findings on such issues were therefore "outside the authority of the court;" thus, the arbitrator's findings regarding such non-existent claims were "utterly void." All that the arbitrator could or should "necessarily"

have decided was that there was a contract for the payment of money by McCarthy to Ashjian, that McCarthy had breached that contract, and that Ashjian had suffered damages. Instead, the arbitrator not only made the unnecessary finding that McCarthy was a "fiduciary" (ER 00783 (1-6:9-10)) but even "went on beyond that," (ER 00783 (1-6:18-19)) and concluded that McCarthy was under a "continuing obligation to hold [Ashjian's] funds in trust and to turn them over . . ." (ER 00784 (1-7:10-11).) McCarthy respectfully submits that the bankruptcy court should properly have disregarded such "findings" by the volunteer arbitrator as the functional equivalent of *dicta* in an appellate opinion. Instead, the bankruptcy court used these "findings" as a contrived justification for granting partial summary judgment.

Second, even assuming that Ashjian had alleged a cause of action for breach of fiduciary duty (which he did not), such claim dated back over seven years and was barred by the relevant three-year statute of limitations,[10] as set forth in [19] California Code of Civil Procedure Section 338. Had such claims been properly pleaded (thereby providing notice of such a claim), McCarthy could have asserted this affirmative defense and prevailed. Indeed, Ashjian's Third Claim, which involved a similar

[10] The purpose of a statute of limitations is "to protect defendants from the stale claims of dilatory plaintiffs." (*Norgart v. Upjohn Co.*, 87 Cal.Rptr.2d 453, 461 (Cal. 1999).) "Inasmuch as it 'necessarily fix[es]' a 'definite period[ ] of time' [citation omitted] it operates conclusively across the board, and not flexibly on a case-by-case basis." (*Norgart* 87 Cal.Rptr.2d at 462.)

alleged debt, was denied because of the expiration of the statute of limitations.[11]

In addition to the absence of any allegation of "breach of fiduciary duty" or similar misdeed, Ashjian's arbitration brief explicitly conceded that although he "believed then, and believes now, that defendant McCarthy has engaged in self-dealing, mismanagement, and other breaches of fiduciary duty" that "for purposes of this litigation, ***that is irrelevant***." (ER 00009 (Arbitration Brief, 2:24-28).) Indeed, any alleged (or in this case, unalleged) "self-dealing, mismanagement, and other breaches of fiduciary duty" have nothing to do with the "breach of contract" and common counts that were at issue in the Municipal Court action. Accordingly, McCarthy respectfully submits that an issue which Ashjian himself admitted was [20] "irrelevant" (and which by any objective measure was in fact irrelevant) is by definition neither "essential" nor "necessary" to the arbitration award.

Accordingly, because "breach of fiduciary duty" was neither "essential to the judgment" nor "necessarily decided" in the Municipal Court action, it was prejudicial error for the bankruptcy court to have granted partial

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[11] At the time of trial, the Court found that the statute of limitations for any claim for breach of fiduciary duty that Ashjian could have raised with respect to the Third Claim began to run in February 1988, when the evidence established that he "distrusted" McCarthy. (ER 01020-01021 (2-55:14-2:56:18).) "The transaction was laid out for him. Mr. McCarthy didn't hide anything." (ER 01021 (2-56:19-20).) Accordingly, even using a four-year statute of limitations (McCarthy respectfully submits that the statute of limitations is actually three years (*see Cal. Code of Civil Procedure* § 338)), Ashjian's claim was untimely. (ER 01022 (2-57:1-2).)

summary judgment based on the doctrine of collateral estoppel.

D. Even Assuming Applying Collateral Estoppel Was Proper, Ashjian Never Proved that McCarthy Caused Damage.

Even assuming the doctrine of collateral estoppel established the breach of a fiduciary duty by McCarthy – which it did not (*see* Sections 1 A-C *supra*) – it was still improper for the bankruptcy court to have granted partial summary judgment in favor of Ashjian in light of the absence of any evidence that such purported breach of fiduciary duty ***caused*** Ashjian any damages. Generally, "proximate cause is usually a factual determination that should be decided at trial." (*Christensen v. Georgia-Pacific Corp.*, 279 F.3d 807, 815 (9th Cir. 2002) (reversing summary judgment *inter alia* because triable issues of fact remained as to causation).) In order to prevail on a complaint to determine nondischargeability, it is not enough to prove merely that a defalcation occurred; rather, a "debt ***must arise from*** a debtor's defalcation in order for the defalcation to render the debt nondischargeable." (*Nestor v. Tucker (In re Nestor)*, 202 B.R. 181, 184 (D. Mass. 1996) (emphasis added).) In *Nestor*, because the plaintiff attempting to assert the nondischargeability of a debt failed to prove that the debtor's defalcation ***caused*** the alleged loss, the bankruptcy court found, and the district court affirmed, that the debt was ***dischargeable***. (*Nestor*, 202 B.R. at 183.)

[21] In this case, McCarthy presented the bankruptcy court with admissible evidence as to the real cause of Ashjian's loss, notably the *CitiSavings* litigation (which

was abruptly and unexpectedly cut short by the intervention of the Resolution Trust Corporation) in which Kau was a plaintiff, coupled with a "drastic fall in real estate prices in the late 80's and early 90's [that] devastated the partnerships' value." (ER 00212.) To the contrary, Ashjian presented ***no*** evidence whatsoever as to the ***cause*** of his loss. (ER 00211.) Indeed, the bankruptcy court admitted that it made "no independent findings" – perhaps because of the dearth of any evidence from Ashjian – and instead relied "exclusively" on the arbitrator's "findings." (ER 00799 (1-22:1-4).) While the Municipal Court arbitrator purported to make findings as to breaches of fiduciary duty by McCarthy, there is no mention whatsoever of causation. (ER 00011.) Accordingly, because there was a triable issue of material fact as to whether Ashjian's loss was caused by McCarthy, it was improper for the bankruptcy court to have granted partial summary judgment. Therefore, this court should reverse the order granting partial summary judgment and remand the case for further proceedings, including trial, as to Ashjian's First Claim.

CONCLUSION

For each of the foregoing reasons, Appellant, Debtor, and Defendant, Charles C. McCarthy, respectfully requests that this Court find that the Bankruptcy Court committed prejudicial error below when it granted Partial Summary Judgment against McCarthy and in favor of Ashjian, that such Partial Summary Judgment be

reversed, and that the matter be remanded for further proceedings, including trial, in the bankruptcy court.

[22] DATED: December 20, 2002

Respectfully submitted,
PRINCE & HEUER
A Professional Law
Corporation

By: /s/ H.T. Heuer
HENRY T. HEUER
Attorneys for Defendant and
Appellant CHARLES C.
MCCARTHY

* * *

APPENDIX I

FREDRICK H. STERN, ESQ. – STATE BAR NO. 58395
LAW OFFICES OF FREDRICK H. STERN
16830 Ventura Boulevard, Suite 500
Encino, California 91436
(818) 990-1070

Attorney for Plaintiff

MUNICIPAL COURT OF THE LOS ANGELES JUDICIAL DISTRICT COUNTY OF LOS ANGELES, STATE OF CALIFORNIA

NAZAR H. ASHJIAN, JR., an individual, Plaintiff, vs. KAU-KONA LAND COMPANY, A California Limited Partnership; CHARLES C. McCARTHY, an individual; JOY McCARTHY, an individual; and DOES 1 through 25, inclusive, Defendants.	CASE NO. 94E04139 PLAINTIFF'S ARBITRATION BRIEF DATE: SEPT. 28, 1995 TIME: 4:30 P.M. PLACE: 6300 WILSHIRE SUITE 9000

This is an action by plaintiff Nazar H. Ashjian, Jr. against defendants Kau-Kona Land Company, a California Limited Partnership ("Kau-Kona"), and Charles C. McCarthy ("McCarthy") for breach of contract in connection with plaintiff's interest in a limited partnership. Plaintiff was at all relevant times a limited partner of Kau-Kona, and defendant McCarthy is the general partner of said partnership. McCarthy is also an attorney.

Kau-Kona was formed in 1967 for the purpose of purchasing and holding real property for investment. In or about July of 1988 defendants Kau-Kona and McCarthy caused partnership distributions to be made to the limited partners of record. Based on his interest in Kau-Kona, plaintiff was to receive a one percent (1%) share of the $2,094,600.00 distribution, or $20,946.00.

Defendants made the above-referenced distribution to limited partners contingent upon their signing a release which stated in relevant part that the signing limited partner agreed to:

> "Release said General Partner, his heirs or assignees from any and all claims which the undersigned may have had, now has or may, at any time in the future, have against said General Partner, his heirs or assignees in any way relating to his stewardship of the affairs of said Partnership, whether in his capacity as General partner, counsel or otherwise."

Plaintiff did not have sufficient information to enter into an agreement releasing the general partner from any liability, and he refused to do so. Since plaintiff would not sign the release, defendants refused to pay to plaintiff his share of the partnership distribution. Even when plaintiff ultimately capitulated and signed the release, defendants refused to pay the monies owed to plaintiff.

Plaintiff had no legal obligation to sign a release in exchange for a distribution of profits from Kau-Kona to which he was entitled. Moreover, plaintiff believed then, and believes now, that defendant McCarthy has engaged in self-dealing, mismanagement, and other breaches of fiduciary duty with respect to the Kau-Kona partnership.

However, for purposes of this litigation, that is irrelevant. Plaintiff is entitled to the receipt of his distribution due as of July 27, 1988 in the sum of $20,946.00. Plaintiff is further entitled to interest at the legal rate from July 27, 1988 to the present in the sum of $15,023.19.

DATED: September 28, 1995

Respectfully submitted,

LAW OFFICES OF
FREDRICK H. STERN

/s/ By Fredrick H. Stern
FREDRICK H. STERN, ESQ.
Attorney for Plaintiff

APPENDIX J

United States Court of Appeal Docket No. 02-568-24
Lower Court Docket No. CV-02-03588-JFW
Bankruptcy Court Case No. SV-96-15656-AG
Adversary No. AD-96-01550-AG

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: CHARLES C. McCARTHY,

Debtor

CHARLES C. McCARTHY, et al.
Defendant and Appellant,
vs.
NAZAR H. ASHJIAN, JR., et al.,
Plaintiff and Appellee,

On Appeal from the United States District Court
for the Central District of California
Honorable John F. Walter

[United States Bankruptcy Court
for the Central District of California –
San Fernando Valley
Honorable Arthur M. Greenwald]

APPELLEE'S BRIEF

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* * *

[1] 1. SUMMARY OF ARGUMENT

Appellant Charles McCarthy asserts that the bankruptcy court, and subsequently the District Court, erred when the bankruptcy court found a California Municipal Court judgment nondischargeable under 11 U.S.C. §523(a)(4) after the bankruptcy court's holding that McCarthy was collaterally estopped from relitigating the issue of whether McCarthy had committed a "defalcation while acting in a fiduciary capacity." McCarthy erroneously contends that: (a) California law does not permit courts to give preclusive effect to a judicial arbitration award and (b) because the Municipal Court complaint did not include a separate tort claim for breach of fiduciary duty the arbitrator's opinion citing a breach of fiduciary duty was *dicta* thereby precluding the application of the collateral estoppel doctrine.

McCarthy's attack upon the sufficiency of the Municipal Court judgment and the application of the doctrine of collateral estoppel have been rendered frivolous, if not moot, by the December 11, 2002 decision of the California Supreme Court denying a petition for writ of review and suspending McCarthy from the practice of law for two years for the ***very acts of defalcation in a fiduciary capacity*** that are the subject of this appeal.[1] McCarthy was ordered to make restitution to Appellee Nazar Ashjian ("Ashjian") for the same sum included in the Municipal Court judgment.

---

[1] *McCarthy On Discipline* (2002 Cal. LEXIS 8763), a copy of which is attached in the Appendix hereto.

The California Supreme Court's denial of a petition for writ of review left standing the detailed decision of the Review Department of The State Bar Court[2] which left no doubt that McCarthy's acts amounted to a defalcation in a fiduciary capacity therefore satisfying the requirements of 11 U.S.C. §523(a)(4):

> "This matter is before this court for review because respondent Charles Connell McCarthy, general partner of Kau-Kona Land Co., a California limited partnership, ("the Kau partnership", "the partnership" or "Kau") [2] was found to have breached is fiduciary duties and misappropriated funds by refusing to distributed to Nazar H. Ashjian, one of the limited partners of Kau, Ashjian's portion of the preliminary distribution of Kau's funds. * * * Upon our independent review of the record (citations) and based on the applicable standards and case law, we find respondent culpable . . . "

The Supreme Court's decision forms a second, independent basis for the application of the doctrine of collateral estoppel.[3] It is a ***second*** order establishing that McCarthy is guilty of fraud or defalcation while acting in a fiduciary capacity. It is a ***second*** order that McCarthy owes Ashjian $27,493.22 plus interest at the rate of 10 percent from November 8, 1995. And while McCarthy demeans the opinion of a court-appointed arbitrator because he is not a public officer and not publicly accountable, there

---

[2] *In re Charles Connell McCarthy* (2002 Cal. LEXIS 2), a copy of which is attached in the Appendix hereto.

[3] By his brief, Appellee requests this Court to augment the record appeal under FRAP 10(e).

can be no demeaning of an opinion that has received the approval of California's ***highest*** court.

One of the basic tenants of appellate law is that the appellant must show harm or injury from the action below. Now that the California Supreme Court has acted, McCarthy has no injury or harm even if he could establish error, because there is a separate order finding him guilty of a defalcation while acting in a fiduciary capacity which is based upon the same facts that were at issue in the Municipal Court action.

Even without the recent decision of the California Supreme Court, McCarthy's contentions of error are without merit. McCarthy argued to the District Court that "California law does not permit courts to give preclusive effect to a judicial arbitration award" and cited as his sole authority *Flynn v. Gordon* (4th Dist., 1989) 207 Cal.App.3d 1550 As Appellee pointed out to the District Court, the *Flynn* opinion was trumped three months after it was issued by a Second Appellate District decision in the case of *State Farm Mut. Auto. Ins. Co. v. Superior Court* (2nd Dist., 1989) 211 Cal. App.3d 5. Despite its obvious applicability, McCarthy opted not to address the *State Farm* decision in his opening brief to this Court.

McCarthy interpreted the municipal court complaint as raising no issue of defalcation in a [3] fiduciary capacity. However, McCarthy was named in the complaint as a general partner of a limited partnership (ER 00002 at ¶3). Because his role as a general partner was identified in the pleadings, he was on notice that he was subject to a fiduciary standard. Ashjian's failure to specifically plead a cause of action for breach of fiduciary duty is inconsequential and does not lead to the conclusion that the issue was

not tried. Ashjian's Arbitration Brief left little doubt that McCarthy was accused of breach of his fiduciary duty in his role as general partner (ER 00009 at line 26). The arbitrator's decision specifically noted that as the general partner he was a fiduciary and that "Mr. McCarthy was under a continuing obligation to hold plaintiff's funds in trust and to turn them over" (ER 00011).

Accordingly, there is no merit to any of the arguments raised by McCarthy and the judgment entered below should be affirmed.

2. STATEMENT OF FACTS

Ashjian filed an action in Los Angeles Municipal Court against McCarthy seeking damages for breach of contract, money had and received and account stated. (ER 00001-00007.) McCarthy was sued in his role as General Partner of the California limited partnership known as Kau-Kona Land Co. (Complaint, ¶¶1 & 3, ER 00001-00002). The matter was ordered to arbitration with the arbitrator entering his award on November 17, 1995 for $31,606.22 in favor of Ashjian and against McCarthy. The award found McCarthy liable for breach of fiduciary duty. (ER 00011.) McCarthy failed to request a trial *de novo* which resulted in the entry of judgment on Ashjian's behalf.

Following McCarthy's filing of Chapter 7 proceedings, Ashjian filed his Adversary Complaint To Determine Dischargeability on August 22, 1996. (ER 00014.) McCarthy filed his Answer on October 4, 1996. (ER 00020.) A Joint Pre-Trial Order was entered on May 13, 1997. (ER 00119.)

Ashjian's motion for summary judgment (ER 00136) was heard on July 23, 1997 and granted in part. The bankruptcy court found in Ashjian's favor on his First Claim, but denied summary judgment as to his Second and Third Claims for Relief (Memorandum of Decision Re: Summary Judgment; ER 00452). In rendering the decision, the bankruptcy court made factual findings (ER 00452-00462) that: (a) McCarthy was a general partner of California limited partnerships in which Ashjian was a limited partner; (b) McCarthy had retained distributions due Ashjian from the limited partnerships of $20,946; [4] (c) an arbitrator in a Los Angeles Municipal Court action had ruled in Ashjian's favor that McCarthy had breached his fiduciary duty as general partner by withholding payment to Ashjian and (d) the Municipal Court judgment was a final judgment on the merits, as McCarthy did not make a motion to vacate the judgment within the six months as prescribed in rule 1615 of the California Rules of Court.

Ashjian's remaining claims proceeded to trial on February 2 and 3, 1998. McCarthy prevailed as to these additional claims. At the conclusion of trial McCarthy was ordered to prepare Findings of Fact and Conclusions of Law and a Judgment. (ER 01033-01034.)

On July 10, 2001, some two and one-half years later, the court issued an OSC for McCarthy to show cause why he failed to comply with the order requiring him to prepare findings and a judgment. (ER 00163.) Hearings were held on July 31, 2001 (ER 01039); August 24, 2001 (ER 01083); and September 5, 2001 (ER 01179). On September 17, 2001, McCarthy filed his Motion To Dismiss Adversary Proceeding for failure to prosecute (ER 00561) which motion was denied on October 11, 2001. (ER 01207.) A

later hearing was held on January 24, 2002 to discuss proposed Findings of Fact and Conclusions of Law. (ER 01250.) Judgment was entered on February 6, 2002 (ER 00714) along with the courts Findings of Fact And Conclusions of Law (ER 00690). The Notice of Appeal was filed by McCarthy on April 22, 2002. (ER 00718.)

3. ARGUMENT

3.1. The Bankruptcy Court's Application Of The Doctrine Of Collateral Estoppel Was Authorized And Correct.

The bankruptcy court correctly applied the doctrine of collateral estoppel to bar re-litigation of whether McCarthy breached a fiduciary duty.

This Court upheld the application of the collateral estoppel doctrine to bar a bankruptcy debtor from re-litigating the issues in a California state court judgment in the case of *Bugna v. McArthur (In re Bugna)* 33 Fd.3d 1054 (9th Cir. 1994). The debtor attacked the district court's ruling applying collateral estoppel to find the debtor's state court judgment non-dischargeable under 11 U.S.C. §523(a)(4), the same attack made by McCarthy, here. On the issue of collateral estoppel, this Court [5] stated:

> "the Supreme Court has held that collateral estoppel applies in dischargeability proceedings. *Grogan v. Garner*, 498 U.S. 279, 111 S. Ct. 654, 658 & n.11, 112 L. Ed. 2d 755 (1991). Here, as in *Grogan*, all the elements of collateral estoppel were satisfied. The bankruptcy court was therefore required to apply collateral estoppel once it was invoked by the creditor. *In re Lockard*, 884 F.2d 1171, 1174 (9th Cir. 1989). In determining

> the collateral estoppel effect of a state court judgment, federal courts must, as a matter of full faith and credit, apply that state's law of collateral estoppel. 28 U.S.C. §§ 1738; *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 481-82, 72 L. Ed. 2d 262, 102 S. Ct. 1883 (1982); *see In re St. Laurent*, 991 F.2d 672, 675-76 (11th Cir. 1993) (upholding the application of state law of collateral estoppel in a bankruptcy case). Accordingly, the collateral estoppel effect of the state court determination of fraud here is governed by California law. Under this law, collateral estoppel bars relitigation when "(1) the issue decided in the prior action is identical to the issue presented in the second action; (2) there was a final judgment on the merits; and (3) the party against whom estoppel is asserted was a party . . . to the prior adjudication." (*Garrett v. City and County of San Francisco*, 818 F.2d 1515, 1520 (9th Cir. 1987).)

Under this holding, the bankruptcy court was compelled to apply the collateral estoppel doctrine because California judgments are entitled to full faith and credit in federal courts.

McCarthy goes on to argue that it is California law that collateral estoppel effect will not be given to judicial arbitration awards. McCarthy relies upon *Flynn, supra*, for the proposition that a judicial arbitration award is not entitled to collateral estoppel effect. McCarthy's reliance is misplaced.

Three months later, after *Flynn* was decided, the Second Appellate District issued its ruling in *State Farm, supra* and rejected *Flynn* to the extent *Flynn* held that judicial arbitration awards could not [6] be given collateral estoppel effect. The court reasoned as follows:

> "There is no question the Legislature [by enacting Code Civ. Proc. §§ 1141.23] intended the award, once final, to be a binding resolution of the particular cause of action. Code of Civil Procedure §1141.23 provides that a final award shall have 'the same force and effect as a judgment in any civil action or proceeding,' except that it shall not be subject to appeal and generally may not be attacked or set aside. Accordingly, a final judicial arbitration award, if clear and unambiguous, is *res judicata* in any subsequent proceeding on the same cause of action."
>
> (211 Cal.App.3d at 10, fn.6.)

The *State Farm* court rejected *Flynn's* holding that judgments entered following judicial arbitration should not be given collateral estoppel effect:

> "While the *Flynn* court reached the right result on its facts, we can not subscribe to the proposition that a final judgment following arbitration proceedings can never have collateral estoppel effect. Here, the *only* issue with which we are concerned is whether State Farm's insureds had *any* liability to the claimant seeking to prosecute the bad faith action. That issue was *actually, necessarily* and *finally* resolved in plaintiffs' favor by the judgment arising from the arbitration award. Clearly, without such a finding of liability, there could be no basis for the arbitrator's award. This was a final resolution of the issue of their insureds' liability and therefore State Farm would be collaterally estopped by such judgment from relitigating that issue in the bad faith action."
>
> (211 Cal.App.3d at 14.)

In *Vandenberg v. Superior Court* (1999) 21 Cal. 4th 815, the California Supreme Court held that [7] a judgment based on a *private* arbitration award does not have collateral estoppel effect in favor of a nonparty to the arbitration absent an agreement giving the judgment such preclusive effect. However, the court specifically noted the disagreement between *Flynn* and *State Farm*, and expressly declined to state any view as to the collateral estoppel effect of a *judicial* arbitration judgment. (21 Cal. 4th at p. 824, fn. 2.)

Accordingly, California law in this jurisdiction holds that collateral estoppel effect can be given to a judicial arbitration judgment.

3.2. McCarthy's Breach Of His Fiduciary Duty Was Decided By The Arbitrator And Was An Essential Element Of His Decision.

McCarthy's contention that Ashjian's Municipal Court complaint failed to include a specific cause of action labeled "breach of fiduciary duty" and that the finding of breach of fiduciary duty was unnecessary to the decision is disingenuous.

McCarthy glosses over the allegations of the complaint and points to the breach of contract claim while ignoring the factual allegations of the common counts. The complaint alleges that McCarthy was the general partner of the California limited partnership, Kau-Kona Land Company and "as such, defendant McCarthy is jointly and severally liable for the obligations hereinafter referred to in this Complaint" (Complaint, at ¶3 ER 00002). The complaint includes a specific cause of action for money had

and received "by defendants for and on behalf of plaintiff" which was unpaid to plaintiff despite demand therefor.

As a matter of pleading, California law requires is [sic] that a plaintiff plead the facts to show some right of recovery. He cannot be thrown out of court because he may have misconceived the form of relief to which he is entitled (4 Witkin, *Calif. Procedure* 4th Ed., Pleading §344 citing *Zellner v.* [8] *Wassman* (1920) 184 Cal. 80, 88).

McCarthy's plea that he had no notice of any claim of breach of fiduciary duty or defalcation is nonsense. He was individually named in addition to the limited partnership, which was an independent legal entity, and alleged to be acting in the role of a general partner of a California limited partnership. In addition to a cause of action for breach of contract, McCarthy was named in common counts for money had and received, for account stated and on an open book account. He was alleged to be personally liable in addition to, and separate from, the partnership entity. The common count for money had and received includes factual allegations virtually identical to the theory of breach of fiduciary duty. The essential facts necessary for a breach of fiduciary duty claim were alleged in the Municipal Court complaint and, accordingly, McCarthy was on notice that these facts were to be litigated and decided.

Thereafter, the arbitrator made the findings that were necessary in order to determine whether McCarthy breached his fiduciary duty and withheld money from Ashjian in violation of that duty:

> "Arbitrator finds that Mr. McCarthy, as general partner of the Kau-Kona Land Company was a fiduciary . . . It was not within Mr. McCarthy's

> discretion or right to require the signing of a release of all claims against him as a precondition to the distribution of plaintiff's share of the partnership profits. Distributions were made to all other limited partners except plaintiff. Mr. McCarthy was under a continuing obligation to hold plaintiff's funds in trust and to turn them over."
>
> (ER 00011)

Accordingly, the record is clear that the issue of breach of fiduciary duty was actually decided by the arbitrator thereby satisfying the rule for application of collateral estoppel as required in *Garrett v. City and County of San Francisco*, 818 F.2d 1515, 1520 (9th Cir. 1987). It simply is not the case, as McCarthy argues, that the Municipal Court action was nothing but a breach of contract action (Opening [9] Brief, at p. 17-18).

3.3. McCarthy's Claim That Damages Were Not Proved Is Frivolous.

McCarthy's contention that Ashjian never proved that McCarthy caused damage is so utterly ridiculous as to warrant only brief comment. The arbitrator found that McCarthy had wrongfully withheld payment of money due Ashjian from the limited partnership, thereby violating his fiduciary duty. The arbitrator awarded the amount of money withheld, $20,946.00, plus interest on that amount from July 27, 1888, the date payment was due. He found that McCarthy had made distributions to all other limited partners except Ashjian. (ER 00011.) The findings of withholding of payment of money due along with the amount of money due dispels any notion that damages and causation lacked proof.

3.4. McCarthy's Statute Of Limitations Defense Is Without Merit.

McCarthy argues that even if Ashjian alleged a breach of fiduciary duty claim, it was time barred under the pertinent statute of limitations. There is nothing in the record before this Court which indicates that McCarthy pleaded the statute of limitations as a defense or raised it either to the arbitrator or the Municipal Court. The arbitrator included in his award a statement that "any statue [sic] of limitations problem is obviated by an acknowledgment of indebtedness sent to plaintiff in 1994 in the form of a K-1." Therefore, it appears that the defense was resolved against McCarthy. McCarthy obviously waived any right to pursue that defense when he failed to request a trial *de novo*.

3.5. The Decision Of The California Supreme Court Renders Any Error Below Harmless.

While the California State Bar proceeding was not a part of the record before the bankruptcy court when the decision was initially made to find the debt owed to Ashjian non-dischargeable, there can [10] be no question now that the California Supreme Court has spoken that McCarthy's actions in withholding payment from Ashjian constitute a defalcation while acting in a fiduciary role. Those facts have been firmly and finally decided. That decision is entitled to full faith and credit by this Court. That decision is equally subject to the collateral estoppel doctrine, just as the Municipal Court judgment. McCarthy's contentions, even if they had merit, which they do not, at best constitute harmless error.

The standard for harmless error in a civil case are less stringent than that in a criminal case. (*Mockler v. Multnomah County* 140 F.3d 808, 813 (9th Cir., 1998). Under the circumstances of this case and the decision of the California Supreme Court as well as the opinion of the Review Department Of The State Bar Court, both of which are matters of public record, it is undeniable that the bankruptcy court's decision should be upheld.

4. CONCLUSION

Appellant Charles McCarthy seeks to waste this Court's valuable time by claiming that he did not engage in conduct that amounted to a defalcation while acting in a fiduciary capacity in accordance with the provisions of 11 U.S.C. §523(a)(4). As an officer of the court, McCarthy has a duty to avoid engaging in needless controversy. Both he and his counsel know that the decision of the California Supreme Court makes a mockery of any contention that McCarthy is not guilty of a defalcation in a fiduciary role. Not only should this Court affirm the judgment below, but sanctions, in addition, are appropriate.

DATED: February 5, 2003

/s/ Nazar H. Ashjian, Jr.
NAZAR H. ASHJIAN, JR.
Appellee, In Pro Per

* * *

APPENDIX K

United States Court of Appeal Docket No. 02-56824
Lower Court Docket No. CV-02-03588-JFW
Bankruptcy Court Case No. SV-96-15656-AG
Adversary No. AD-96-01550-AG

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re: CHARLES C. McCARTHY,

Debtor

CHARLES C. McCARTHY, et al.

Defendant and Appellant,

vs.

NAZAR H. ASHJIAN, JR., et al.,

Plaintiff and Appellee.

On Appeal from the United States District Court
for the Central District of California
Honorable John F. Walter

[United States Bankruptcy Court
for the Central District of California –
San Fernando Valley
Honorable Arthur M. Greenwald]

APPELLANT'S REPLY BRIEF

* * *

[1] INTRODUCTION

Appellant, Defendant, and Debtor, Charles C. McCarthy ("McCarthy"), respectfully submits his reply to the Appellee's Brief submitted by Appellee and Plaintiff, Nazar H. Ashjian, Jr. ("Ashjian").

RESPONSIVE STATEMENT OF FACTS

Although an accurate and complete Statement of Facts is set forth in the Appellant's Opening Brief, the Appellee's Brief contains such egregious misrepresentations of fact that a brief response is required.

The Appellee's Brief claims that "Ashjian's Arbitration Brief left little doubt that McCarthy was accused of breach of his fiduciary duty in his role as general partner" but does not quote any particular portion of the Arbitration Brief. (Appellee's Brief, 3:5-6.) To the contrary, Ashjian's Arbitration Brief specifically admitted otherwise: "plaintiff believed then [in July 1988], and believes now, that defendant, McCarthy has engaged in self-dealing, mismanagement, and other breaches of fiduciary duty with respect to the Kau-Kona partnership. However, for purposes of this litigation, that is ***irrelevant***." (Ashjian Arbitration Brief, 2:24-28 (ER 00009).)

The Appellee's Brief also falsely claims that "[a]t the conclusion of trial, *McCarthy* was ordered to prepare

Findings of Fact and Conclusions of Law and a Judgment" (Appellee's Brief, 4:6-7) and that "[o]n July 10, 2001, some two and one-half years later, the court issued an OSC for *McCarthy* to show cause why he failed to comply with the order requiring him to prepare findings and a judgment" [2] (Appellee's Brief, 4:8-10[1]). To the contrary, at the conclusion of trial, the reporter's transcript makes clear that it was not McCarthy individually but rather James Felton and his law firm, Greenberg & Bass, that were ordered to prepare the findings and the judgment. (ER[2] 01060-01061[3] (February 3, 1998 transcript 2-68-2-69).) Similarly, the Order to Show Cause, which was issued some ***three*** and one-half (not two and one-half as Ashjian claims) years after the conclusion of trial, states on its face that it was directed at Felton and Greenberg & Bass, and not at McCarthy individually. (ER 00463-00464.) Ashjian conveniently neglects to mention his own failure to comply with Local Bankruptcy Rule 9021-1[4] and his admission

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[1] In support of this purported fact, Ashjian cites to page 00163 of the Excerpts of Record, which is a page from a 1988 purchase agreement that is not, and does not even refer to, an Order to Show Cause.

[2] As in the Appellant's Opening Brief, "ER" shall mean and refer to the Appellant's Initial Excerpts of Record.

[3] This citation was erroneously specified in the Opening Brief as ER 1033-1034. Ashjian, who apparently did not check either the page number of the text contained therein, repeated this citation error in the Appellee's Brief (4:7) while also misrepresenting the content.

[4] Local Bankruptcy Rule 9021-1 provides in relevant part:

> " . . . judgments shall be served and lodged with the clerk within seven (7) court days of the granting thereof." (Local Bankruptcy Rule 9021-1(a)(1)(C).) If no proposed judgment is submitted within that time period, "then any other party present at the hearing may lodge and serve a proposed order. . . . If no one submits a proposed . . . Judgment, the court may prepare and enter such order . . . as it may deem

(Continued on following page)

that he "could have prepared the findings and judgment, or at least [3] brought the failure of Mr. Felton to do so" (ER 00616) but did neither. The bankruptcy court made clear that Ashjian was not excused for his failure to do so:

> The Court: So you relied on Mr. Ashjian to come and start yelling and screaming where are the findings, but he never did it either. But he was a pro per.
>
> Mr. Felton: Well, he had counsel at the trial, Your Honor. He did – Mr. Abrunzo was his counsel at the trial.
>
> The Court: Oh, that's right. . . . But they didn't – and that doesn't – you know –
>
> Mr. Felton: It doesn't excuse me. You're right.
>
> The Court: It doesn't excuse you, but it also doesn't excuse him either. . . . Because he had, as pointed out by – Mr. McCarthy's right about the fact that if one party doesn't, the other party has certainly the right to come in and propose findings. . . . But that wasn't done. So with respect to Mr. Ashjian . . . I guess he doesn't care whether it's ever entered or not. . . . (ER 01184-01185 (August 24 2001 Reporter's Transcript, 73:7-74:4).)

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appropriate, including an order to show cause why the . . . proceeding should not be dismissed without prejudice for failure to prosecute. (Local Bankruptcy Rule 9021-1(a)(1)(C).)

LEGAL ARGUMENT

1. The Bankruptcy Court Committed Reversible Error When It Entered an Order Awarding Partial Summary Judgment in Favor of Ashjian and Against McCarthy.

A. The *Bugna* Case is Distinguishable on Its Facts from the Instant Case.

Ashjian first cites the case of *Bugna v. McArthur (In re Bugna)*, 33 F.3d 1054 (9th Cir. 1994), in which the debtor challenged the applicability of the doctrine of collateral estoppel, "the same attack made by McCarthy here." (Appellee's Brief, 4:24-28.) To the extent that Ashjian was attempting to set forth the general rule that "collateral estoppel applies in nondischargeability proceedings," such discussion was unnecessary, as this point was specifically acknowledged in McCarthy's Opening Brief at page 12. To the extent that Ashjian is attempting to [4] claim that *Bugna* is dispositive and justifies the bankruptcy court's erroneous application of collateral estoppel in this case, he is incorrect. In *Bugna*, the defendant was actually sued for fraud and breach of fiduciary duty in California state court, where a jury awarded the plaintiff both compensatory and punitive damages. (*Bugna*, 33 F.3d 1054 at 1056.) "The bankruptcy court reviewed the state court record, found that collateral estoppel precluded Bugna from relitigating the issues of fraud and breach of fiduciary duty, and held the entire award nondischargeable." (*Bugna*, 33 F.3d 1054 at 1056.) On appeal, the Ninth Circuit considered

> whether the issues faced by the bankruptcy court in the dischargeability proceeding were identical to those litigated and determined in state court. There are two issues under section 532(a)(4):

> ***whether the debtor incurred the debt by committing fraud or defalcation,*** and ***whether the fraud was in relation to the debtor's fiduciary responsibilities.*** [citation omitted] The bankruptcy court correctly found that these issues were litigated and resolved against Bugna in the state court proceeding. Bugna had a ***full trial on the issue of fraud,*** and the ***verdict on breach of fiduciary duty*** subsumed a finding that Bugna owed McArthur a fiduciary duty as his partner and real estate broker. (*Bugna*, 33 F.3d 1054 at 1057.)

In stark contrast to *Bugna*, Ashjian sued McCarthy in Los Angeles Municipal Court, where he did not even allege causes of action for fraud or breach of fiduciary duty, but rather only claims for breach of contract and "common counts." (ER 00001-00007.) Whereas in *Bugna*, the fraud and breach of fiduciary duty claims were specifically alleged and actually determined by a jury following a "full trial," Ashjian in this case did not allege any such claims (ER 00001-00007), specifically admitted that the issue of breach of fiduciary duty was "irrelevant" (ER 00009), and the matter was only mentioned in *dicta* by the volunteer arbitrator. Accordingly, because it is silent as to situations such this case – where the issues [5] decided in the Municipal Court action were neither "necessary" to that decision nor "identical" to issues presented in the bankruptcy court – *Bugna* is inapposite. Rather, because the Municipal Court issues were neither "necessary" nor "identical" (*see Coscia v. McKenna & Cuneo*, 108 Cal.Rptr.2d 471, 25 Cal.4th 1194, 1201, n.1 (Cal. 2001)) and because under California law, collateral estoppel does not apply to judicial arbitration awards (*Flynn v. Gorton*, 225 Cal.Rptr. 768, 771-72 (Cal. Ct. App. 1989), this Court should reverse the order granting partial summary judgment in favor of

Ashjian and remand this case to the bankruptcy court for further proceedings, including trial, as to Ashjian's First Claim.

B. The *State Farm* Case is Distinguishable on Its Facts from the Instant Case.

Ashjian erroneously claims that the case of *State Farm Mutual Auto. Ins. Co. v. Superior Court (Ortega)*, 259 Cal.Rptr. 50 (Cal. Ct. App. 1989) "trumped" and "rejected" the holding in *Flynn*. (Appellee's Brief, 2:20-22; 5:27-6:1.) To the contrary, *State Farm* specifically states that "the *Flynn* court reached the right result on its facts." (*State Farm*, 259 Cal.Rptr. at 54.) Moreover, *State Farm* involved a different issue: following the California Supreme Court's decision in *Moradi-Shalal v. Fireman's Fund Ins. Companies*, 250 Cal.Rptr. 116, 46 Cal.3d 287[5] (Cal. 1988),[6] "does an award made in a judicial arbitration proceeding and [6] entered as a judgment against State Farm's insureds . . . constitute a conclusive judicial determination of such insured's liability . . . ?" (*State Farm*, 259 Cal.Rptr. at 51.) In other words, in *State Farm*, "the ***only*** issue . . . [was] whether State Farm's insureds had ***any liability*** to the claimant seeking to prosecute the bad

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[5] Because the California Reporter page references were unavailable through Lexis, the page citations to *Moradi-Shalal* are to the official California Reports.

[6] In *Moradi-Shalal*, the California Supreme Court required that in any third-party bad faith case against an insurance company pending as of the date its decision became final, "there must be a conclusive judicial determination of the insured's liability before the third party can succeed" in such action. (*Moradi-Shalal*, 46 Cal.3d at 306.)

faith action." (*State Farm*, 259 Cal.Rptr. at 55 (emphasis added).) The *State Farm* court concluded that "for the ***limited purposes*** of satisfying *Moradi-Shalal*" (*State Farm*, 259 Cal.Rptr. at 55 n.12 (emphasis added)) a judicial arbitration entered as a judgment was "a sufficient judicial resolution of the insureds' liability. . . . and Plaintiffs, by virtue of a final judgment in their favor in the underlying action, have sufficient standing to proceed with their bad faith action against State Farm. . . . " (*State Farm*, 259 Cal.Rptr. at 56.)

By comparison, in this case, there is no dispute that a volunteer arbitrator for the Municipal Court found ***some liability*** (*i.e.*, for breach of contract and common counts) on the part of McCarthy to Ashjian.[7] The contested issue was whether *dicta*[8] in the underlying decision of a volunteer arbitrator had decided whether there was ***liability for breach of fiduciary duty***. Inasmuch as Ashjian did not allege any such claims (ER 00001-00007) and specifically admitted that the issue of breach of fiduciary duty was "irrelevant" (ER 00009), it is respectfully submitted that this issue was wrongly decided in Ashjian's favor by the bankruptcy [7] court. In *State Farm*, the finding of "any liability" at all was necessarily subsumed in any judicial arbitration award: "Clearly, without such a finding of liability, there could be no basis for the arbitrator's award." (*State Farm*, 259 Cal.Rptr. at 54.) However, in

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[7] However, McCarthy disputes the correctness of such finding.

[8] Under California law, "dicta is defined as "arguments and general observations, ***unnecessary to the decision***, *i.e.*, . . . with ***no force as precedents.***" (*Bunch v. Coachella Valley Water Dist.* 262 Cal. Rptr. 513, 518 (Cal. Ct. App. 1989).)

this case it does ***not*** follow – logically or otherwise – that a finding of ***some*** liability by a volunteer arbitrator necessarily subsumes a finding of liability for ***breach of fiduciary duty***. Here, unlike *State Farm*, even without a finding of liability for breach of fiduciary duty, there ***could*** be a different basis for the arbitrator's award, namely the causes of action for breach of contract and common counts that were actually alleged. Indeed, the causes of action that Ashjian actually alleged should properly be the ***only possible*** bases for any finding of liability.

Accordingly, *State Farm*, though it was decided in this district and subsequent to *Flynn*, is inapposite to this case. Instead, this case is controlled by *Flynn*, which, according to *State Farm*, held that collateral estoppel "did not apply since the claim asserted by Flynn . . . was a ***different cause of action*** than the claim asserted in [the prior] arbitration." (*State Farm*, 259 Cal.Rptr. at 54.) Thus, the bankruptcy court committed reversible error when it applied collateral estoppel to the underlying judicial arbitration award and granted partial summary judgment in Ashjian's favor. This Court should reverse that order and remand this case to the bankruptcy court for further proceedings, including trial, as to Ashjian's First Claim.

C. <u>The Doctrine of Judicial Estoppel Precludes Ashjian from Disputing His Admission that "Breach of Fiduciary Duty" was "Irrelevant" to the Underlying Municipal Court Action.</u>

The doctrine of judicial estoppel – a separate but similar concept from "collateral estoppel" – is described as follows:

> [8] The concept of judicial estoppel ***prevents a party from asserting a position in a judicial proceeding that is contrary or inconsistent with a position previously asserted in a prior proceeding.*** The purpose is to ***protect the integrity of the judicial process*** and not the parties of the lawsuit. [citation omitted] 'The doctrine of judicial estoppel, sometimes referred to as the ***doctrine of preclusion of inconsistent positions***, is invoked to prevent a party from changing its position over the course of judicial proceedings when such positional changes have an adverse impact on the judicial process.' [citation omitted] 'The policies underlying preclusion of inconsistent positions are 'general consideration[s] of the ***orderly administration of justice*** and regard for the ***dignity of judicial proceedings***. . . . ' consequently, judicial estoppel is especially appropriate where a party has taken inconsistent positions in separate proceedings. (*International Engine Parts, Inc. v. Feddersen and Co.*, 75 Cal.Rptr.2d 178, 181 (Cal. Ct. App. 1998).)

Here, Ashjian explicitly conceded in his arbitration brief in the underlying Municipal Court action that although he "believed then, and believes now, that defendant McCarthy has engaged in self-dealing, mismanagement, and other breaches of fiduciary duty" that "for purposes of this litigation, ***that is irrelevant.***" (ER 00009.) Now, however, in the face of this prior admission (which he does not discuss in his brief even in passing), Ashjian has reversed course and now purports to argue that the purported "breach of fiduciary duty was actually decided by the arbitrator." (Appellee's Brief, 8:25-26.) Under the doctrine of judicial estoppel, because

Ashjian is precluded from taking such a position, this Court should disregard such argument.

D. "Breach of Fiduciary Duty" was Not "Necessarily" Decided Nor Was "Fraud, Defalcation, or Breach of Fiduciary Duty" "Identical" to Any Issue Decided in the Municipal Court Action.

Ashjian argues, without citation, that "It is simply not the case, as McCarthy argues, that the Municipal Court action was nothing more but a breach of contract [9] action." (Appellee's Brief, 8:27-28.) In fact, McCarthy accurately recited that "On May 13, 1994, Ashjian commenced a lawsuit against McCarthy by filing his 'Complaint for Breach of Contract; Common Counts'" (as Ashjian's complaint was in fact titled; *see* ER 00001) and setting forth the specific "common counts" alleged. (Opening Brief, page 4, n.2.) Ashjian also erroneously intimates that "Money Had and Received" is "virtually identical" and sufficiently tort-like as to be a substitute for actually alleging a cause of action for breach of fiduciary duty. (*See Haigler v. Donnelley*, 17 P.2d 331, 335 (Cal. 1941) ("it is established in California that an action for money had and received is *ex contractu* in nature").) Indeed, a review of the document itself discloses that the word "fiduciary" does not appear anywhere even once in the Municipal Court complaint, let alone in a non-existent cause of action for "breach of fiduciary duty." (ER 00001-00007.)

Ashjian also falsely claims that "McCarthy's plea that he had no notice of any claim of breach of fiduciary duty or defalcation is nonsense.... The essential facts were alleged in the Municipal Court complaint and accordingly, McCarthy was on notice that these facts were to be litigated

and decided." (Appellee's Brief, 8:2-3; 8:10-11.) However, not only does Ashjian provide no citation to the record to support such claim, he is also incorrect on the law. Vague, general allegations buried in other-titled causes of action are insufficient as a matter of law to plead a claim for breach of fiduciary duty, defalcation, or fraud, which under California law must be "pleaded with specificity." (*Lim v. The.TV Corp. Int'l.* 121 Cal.Rptr.2d 333, 339 (Cal. Ct. App. 2002).) Unidentified "essential facts" that purportedly appear in some unspecified portion of the record – coupled with the lack of any specifically pleaded causes of action – were and are inadequate to put McCarthy on notice that he was purportedly being sued for breach of fiduciary duty, defalcation, or fraud.

[10] Thus, this Court should be compelled to find that "breach of fiduciary duty" was not "identical" to an issue previously decided in the Municipal Court action. To the extent it does appear as *dicta* in the arbitrator's award (ER 00011-00013), "breach of fiduciary duty" was not "necessary" to the resolution of the Municipal Court "breach of contract" action. Moreover, because it was not properly before the volunteer arbitrator, to the extent the arbitrator purported to find McCarthy liable for "breach of fiduciary duty," such award (and corresponding judgment) is void. (*See Michel v. Williams*, 56 P.2d 546, 547 (Cl. Ct. App. 1936); *see also Rochin v. Pat Johnson Mfg. Co.*, 79 Cal.Rptr.2d 719, 725-26 (Cal. Ct. App. 1998) ("doctrine of res judicata is inapplicable to void judgments").)

Accordingly, the bankruptcy court committed reversible error when it applied collateral estoppel to the underlying judicial arbitration award and granted partial summary judgment in Ashjian's favor. This Court should reverse that order and remand this case to the bankruptcy

court for further proceedings, including trial, as to Ashjian's First Claim.

E. Had Ashjian Pleaded a Cause of Action for Breach of Fiduciary Duty, McCarthy Could Have Defeated Such a Claim with a Statute of Limitations Defense.

Ashjian takes issue with the idea that had he bothered to allege a cause of action for breach of fiduciary duty, that McCarthy could have defeated it by way of the affirmative defense of the statute of limitations (*see* Opening Brief, pages 18-19, n.10-11): "There is nothing in the record before this Court which indicates that McCarthy pleaded the statute of limitations as a defense or raised it either to the arbitrator or the Municipal Court." (Appellee's Brief, 9:16-18.) Ashjian's argument only proves the point: there is no record of the statute of limitations [11] because McCarthy did not plead such an affirmative defense to Ashjian's non-existent, unalleged claim for breach of fiduciary duty.[9] Ashjian has cited no legal authority that requires a defendant to be so prescient as to assert affirmative defenses to claims that are not even alleged.

Had McCarthy been on notice to assert the statute of limitations defense, he would have prevailed on that basis in the Municipal Court. Under California's 'discovery rule,' the running of a statute of limitations is only postponed:

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[9] It is also worth noting that the lack of a record was one of the specific reasons cited by the *Flynn* court for not applying the doctrine of collateral estoppel to judicial arbitration awards. (*See Flynn*, 255 Cal.Rptr. at 771-772.)

> until the plaintiff discovers or has reason to discover, the cause of action. [citation] [¶] [T]he plaintiff discovers the cause of action when he at least suspects a factual basis, as opposed to a legal theory, for its elements, even if he lacks knowledge thereof – when, simply put he at least ***'suspects . . . that someone has done something wrong'*** to him [citation], 'wrong' being used, not in any technical sense but in accordance with its 'lay understanding.' [citation] He has reason to discover the cause of action when he has a reason to suspect a factual basis for its elements [citation]. He has reason to suspect when he has ***'notice or information of circumstances to put a reasonable person on inquiry'*** [citation]; he need not know the 'specific facts' necessary to establish' the cause of action. . . . within the applicable limitations period he ***must indeed seek to learn the facts necessary to bring the cause of action in the first place – he 'cannot wait for' them 'to find' him and 'sit on' his 'rights;' he 'must go find' them himself.*** . . . (*Norgart v. The Upjohn Co.*, 87 Cal. Rptr. 2d 453, 463-64 (Cal. 1999) (emphasis added).)

In this case, Ashjian's Arbitration Brief specifically admitted that he "believed then [in ***July 1988***] that defendant, McCarthy has engaged in self-dealing, mismanagement, and other breaches of fiduciary duty with respect to the Kau-Kona partnership." (ER 00009.) Thus, Ashjian suspected that McCarthy had [12] "done something wrong to him" more than six years before the Municipal Court complaint was filed on May 13, 1994 (ER 00001), well beyond the applicable statute of limitations (*see Cal. Code of Civil Procedure* § 338). Accordingly, Ashjian's statute of limitations to allege a breach of

fiduciary duty had long expired by the time that his complaint was filed.[10]

F. Business & Professions Code § 6106, the Underlying Basis of the State Bar Disciplinary Proceeding, Is Unconstitutional on its Face.

Finally, Ashjian erroneously argues that the California Supreme Court's denial of McCarthy's Verified Petition for Writ of Review in connection with a state bar disciplinary matter, in which McCarthy was charged with committing an act of moral turpitude in violation of California Business & Professions Code Section 6106 ("Section 6106"), is somehow dispositive of the instant case. (Appellee's Brief, 1:10-14: 2:5-11.) Ashjian is wrong.

This Court recently decided the case of *Canatella v. California*, 304 F.3d 843 (9th Cir. 2002), which has been remanded to the district court for a determination whether, *inter alia*, Section 6106[11] is unconstitutional on its face for vagueness and overbreadth in violation of the First and Fourteenth Amendments of the United States Constitution. (*Canatella*, 304 F.3d at 848.) A final, retroactive determination in *Canatella* that Section 6106 is unconstitutional under federal law [13] would obviously

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[10] As noted in the Opening Brief (pages 18-19, n.10-11), Ashjian's third Claim was denied on this very basis.

[11] California Business & Professions Code Section 6106 is the very statute McCarthy was charged with violating in his state bar disciplinary proceeding. This is the only count that had anything to do with Ashjian's claims in the instant case.

render null and void any discipline imposed against McCarthy.

However, because Ashjian has chosen to raise the issue in this forum, McCarthy respectfully submits that this Court can and should determine whether Section 6106 is so vague and overbroad on its face that it violates the United States Constitution.

1. California Business & Professions Code § 6106 Is Unconstitutionally Overbroad.

"The overbreadth doctrine prohibits the Government from banning unprotected speech if a substantial amount of protected speech is prohibited or chilled in the process." (*Ashcroft v. The Free Speech Coalition*, 535 U.S. 234, 255; 122 S. Ct. 1389; 152 L. Ed. 2d 403 (2002) (finding portions of the Child Pornography Prevention Act of 1996 unconstitutionally overbroad.) "The Constitution gives significant protection from overbroad laws that chill speech within the First Amendment's vast and privileged sphere. Under this principle, [a statute] is unconstitutional on its face if it prohibits a substantial amount of protected expression." (*Id.*) Federal courts may properly entertain facial challenges to statutes that burden expression. (*Id.*)

Section 6106 provides in relevant part: "The commission of any act involving moral turpitude, dishonesty or corruption, whether the act is committed in the course of his [or her] relations as an attorney or otherwise, and whether the act is a felony or misdemeanor or not, constitutes a cause for disbarment or suspension." (*California Business & Professions Code* § 6106.) While conduct such as murder, kidnapping, and child molestation unquestionably falls within the category of "moral turpitude," the

California State Bar (the governmental entity ostensibly entrusted with enforcing Section 6106) has also prosecuted attorneys on [14] charges of moral turpitude based on "activities as an advocate of [the attorney's] clients' interests in judicial proceedings" (*Canatella*, 304 F.3d at 847) as well as for conduct simply "deemed 'willful' for disciplinary purposes, even if there was no deliberate wrongdoing." (*Lipson v. State Bar of California*, 281 Cal.Rptr. 775, 779; 53 Cal. 3d 1010 (1991).) McCarthy respectfully submits that because it punishes[12] attorneys for a range of expression and conduct that is so broad as to include oral advocacy in a courtroom, Section 6106 is unconstitutionally overbroad and should be stricken.

2. California Business & Professions Code § 6106 Is Unconstitutionally Vague.

"It is established that a law fails to met the requirements of the Due Process Clause if it is so vague and standardless that it leaves the public uncertain as to the conduct it prohibits. . . . " (*Giaccio v. Pennsylvania*, 383 U.S. 399, 402-403, 15 L. Ed. 2d 447, 86 S. Ct. 518 (1966).) "The Constitution does not permit a legislature to 'set a net large enough to catch all possible offenders, and leave it to the courts to step inside and say who could be rightfully detained, and who should be set at large.' This ordinance is therefore vague 'not in the sense that it requires a person to conform his conduct to an imprecise but comprehensible normative standard, but rather in the

[12] While Section 6106 imposes no criminal penalties, a finding of "moral turpitude" culpability may result in the loss of an attorney's livelihood by disbarment.

sense that no standard of conduct is specified at all.'" (*Chicago v. Morales*, 527 U.S. 41, 60; 119 S. Ct. 1849; 144 L. Ed. 2d 67 (1999) (citations omitted) (finding Chicago's Gang Congregation Ordinance prohibiting loitering in public places unconstitutionally vague).)

[15] With respect to Section 6106, like the Chicago Gang Congregation Ordinance, there is no "standard of conduct" specified. Indeed, the California Supreme Court has admitted that "the concept of moral turpitude escapes precise definition." (*Chadwick v. State Bar*, 49 Cal.3d 103, 110 (Cal. 1989).) Section 6106 simply refers baldly to the nebulous concept of "moral turpitude." The rest of the statute does not come close to imposing definitional limitations or standards but rather broadens 6106's scope even further to include any acts "committed in the course of his [or her] relations as an attorney or otherwise, and whether the act is a felony or misdemeanor or not." McCarthy respectfully submits that because its language is so vague that no California attorney can be certain as to the [sic] what is meant (and prohibited as) "moral turpitude," Section 6106 is unconstitutionally vague and should be stricken accordingly.

[16] CONCLUSION

For each of the foregoing reasons, Appellant, Debtor, and Defendant, Charles C. McCarthy, respectfully requests that this Court find that the Bankruptcy Court committed prejudicial error below when it granted Partial Summary Judgment against McCarthy and in favor of Ashjian, that such Partial Summary Judgment be reversed, that the matter be remanded for further proceedings, including trial, in the bankruptcy court, and that this

Court find that California Business and Professions Code Section 6106 is unconstitutional on its face.

DATED: February 19, 2003

Respectfuly submitted,
PRINCE & HEUER
A Professional Law
Corporation
By: /s/ Henry T. Heuer
HENRY T. HEUER
Attorneys for Defendant and
Appellant CHARLES C.
McCARTHY

* * *

APPENDIX L

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

In the Disciplinary Matter of CHARLES CONNELL McCARTHY #20803	)))))	ORDER

The Court has received a response to its Order to Show Cause dated February 21, 2003, from the above-referenced attorney for the imposition of suspension from the Bar of this Court as a result of suspension from the State Bar of California.

Upon review of the Order to Show Cause response letter dated March 19, 2003, the Court denies the request that the proceedings against the above-mentioned attorney be stayed until the Supreme Court of the United States rules upon the above-mentioned attorney's Petition for a Writ of Certiorari.

Therefore, IT IS ORDERED, that the above-referenced attorney is suspended from the practice of law in this Court pursuant to Rule 83-3.1.9 of the Local Rules for the Central District of California.

IT IS FURTHER ORDERED that the above-referenced attorney who has been suspended from the Bar of this Court will be reinstated upon proof of his or her

reinstatement as an active member in good standing with the State Bar of California.

DATE: 4/7/03 /s/ Consuelo B. Marshall
Consuelo B. Marshall
Chief United States District Judge